	2017 Return (Gross)	9 Year Annualized (Gross)	Value of $10M (Gross)	Correlation to the S&P 500	2017 Return (Net)	9 Year Annualized (Net)	Value of $10M (Net)
Prime Long Only Unlevered (100% Long)	14.33%	32.25%	$123.7M	0.52	13.10%	26.72%	$84.2M
Benchmark: **S&P 500 Total Return, w/ Dividends**	21.83%	16.02%	$38.1M	1.00	21.83%	16.02%	$38.1M
Prime Traditional Long/Short (125% Long, 60% Short)	0.28%	26.24%	$81.4M	.14	-0.16%	21.05%	$55.8M
Benchmark: **HFRX Equity Hedge Index**	n/a	n/a	n/a	0.80	9.98%	2.64%	$12.6M
Prime Ultra Hedged Unlevered (100% Long, 90% Short)	-11.07%	17.04%	$41.2M	-0.06	-11.34%	13.08%	$30.2M
Prime Ultra Hedged 50% Cash (50% Long, 40% Short)	-4.49%	11.76%	$27.2M	0.08	-4.72%	9.65%	$22.9M
Benchmark: **HFRX Market Neutral Index**	n/a	n/a	n/a	0.17	1.73%	-0.36%	$9.70M

Figures as of December 31, 2017

Dear Investors and Friends,

First things first—our numbers for 2017. Our Long Only Unlevered finished the year up +13.10%, while our Traditional Long/Short was down slightly at -0.16%, and our Ultra Hedged Unlevered was down -11.07%. Since inception, out Long Only Unlevered portfolio has averaged 26.72% annually, and our Traditional Long/Short portfolio has averaged 21.05% annually.

Some of our best performers, on the long side, were NVIDIA (NASDAQ:NVDA), Activision Blizzard (NASDAQ:ATVI), and BlackBerry (NYSE:BB), while some of our worst performers were Hi-Crush Partners (NYSE:HCLP), Sprint (NYSE:S), and Hawaiian Holdings (NASDAQ:HA).

As always, in 2017 we had only one eye on our annual results; *much* more importantly, we sought to establish *sustainable* long-term performance, which can't be accurately measured on a yearly basis. We believe we are on track with our long-range vision for Prime, and we are doing this through exhaustive analysis of companies and careful stock-picking combined with rigorous risk management. As a practice, Prime is not interested in securing short-term "wins" that are soon offset by losses, but rather in finding underpriced and undervalued companies whose true value reveals itself "organically" over time—typically in multi-year timeframes—and in using conservative investment practices so as to greatly reduce the risk of substantial and dramatic losses.

We believe, as we've said before, that a five-year window (or longer) is needed to accurately evaluate an investment manager's skills, strategies, and true performance. At Prime we are all about sustainability over the long term. As evidence of this, $1 million invested in our Long Only Unlevered portfolio at our launch in 2009 would now be worth $8.42 million. We don't expect every year to pack a knockout punch; our aim is to be still standing, and holding a victory belt, after "fifteen rounds."

What is our Sustainable Competitive Advantage?

In every annual letter we try to share our investment philosophy with you, and give you an idea of the type of in-depth analysis we perform on each company we invest in. In our view, a fund manager's main goal should be to deliver the highest risk-adjusted returns, measured over a long period of time. Ultimately, what sets good managers apart from mediocre ones is (1) their ability to accurately and consistently assess the prospects of companies, and (2) their courage and patience to remain invested in those companies through the volatility inherent in the public markets.

Both of these qualities are essential. Smart investing is not a game of spotting occasional winners. You must be able to generate results over the long term. We do this by working hard to analyze industry trends, changing technologies, and global economic shifts, and to spot companies that are poised to thrive in the changing conditions of the present and future—while simultaneously recognizing other companies that appear headed for stormy waters. However, insight alone is not enough to make a great manager; you must *have confidence* in your analyses as well. This means having the guts to pull the trigger when you see the combination of factors you like, even if this entails bucking conventional wisdom and swimming against the tide of popular opinion.

We believe the market has always been, and always will be, fundamentally inefficient. For that reason, volatility can be our friend—provided we stay the course and remain rational, while others are operating on emotion. Our role as managers is to wisely and watchfully exploit the market's inefficiencies for the benefit of our investors. Over the nine years of our existence, we have been repeatedly able to identify companies whose prospects were being dramatically undervalued (and overvalued on the short side), as reflected by their valuations (i.e., "the market's assessment"). We have done this at a rate that convincingly and consistently outpaces the overall performance of the S&P 500 over the long-term.

The Most Important Thing: Accurately Assessing Companies' Long-Term Prospects

All of our successful investments share a common thread: we **accurately assessed the underlying companies' *long-term* prospects**. If the facts are correctly analyzed, and the future prospects are accurately assessed, stock prices will eventually follow. Though the exact path the graph will take on a short-term basis can't be predicted by anyone, spotting the correct *overall trajectory* is the important thing. And we have done this time and time again. Quarter after quarter, the companies we've invested in have produced operational results in line with our expectations, and their stock prices have increased accordingly. In our view, accurately identifying undervalued companies—using sound premises and detailed analyses—is the only way to generate sustainable outperformance on a risk-adjusted basis.

Correctly forecasting what the next several quarters will look like is not sufficient; in order to sustainably outperform the market, a sound understanding of each company's long-term operational and financial

profile is required. This means taking numerous variables into careful consideration—the strength of its management team, the viability of its products and strategies, the competitive moat it looks to enjoy over the next several years, etc. When all of these factors come together as you assessed they would, the company is able to compound its free cash flows, your theses start to play out, and the market begins to re-assess the company's value. All of this leads to sizable returns over long periods of time. The goal is to see the unrealized value while it is still largely unrealized.

Simply put, this is our "secret sauce." Doing the hard work to accurately assess companies' long-term prospects is the foundation upon which we have been able to generate annualized net returns of 26.72% over nine years, with no leverage, options, or derivatives used (Long Only Unlevered returns). We are immensely proud of producing these returns for our investors, and are laser-focused on continuing to manage the fund to the best of our ability.

A "Prime" Example: Amazon, Inc. (NASDAQ: AMZN)

A prime example (pun acknowledged) of our stock-picking approach is our investment in Amazon, Inc. (NASDAQ: AMZN). As we do with every investment, we researched Amazon rigorously, and the facts ultimately led us to conclude that the stock was dramatically undervalued. It is important to note that at the time, the company was seen as a risky play, and Amazon's operational dominance was seen as anything but a high probability. However, we followed the facts, invested, and exercised the patience required to realize the tremendous gains the company delivered. We first invested in December 2009 at an average price of $135.51, *and—importantly—have remained invested ever since*. As of year-end 2017, AMZN was priced at $1,169.47 per share, resulting in an 8.6x return, or 30.9% annualized.

We are very proud of this result and grateful for the gains it delivered to you, our partners. However—and more importantly for our present purposes—we want to examine the *thought process* behind this investment. The process we followed with Amazon mirrors the type of process we follow with every investment. We've chosen to discuss Amazon this year as this case clearly illustrates the type of returns that are possible when one can **accurately assess the long-term prospects of a company**.

So, what was our thesis and process with Amazon?

As with every investment, one of the primary pieces of analysis we did was to assess the strength of Amazon's competitive moat, the size of its current and potential markets, and the probability of its successfully executing on its long-term plan. Ultimately, all of this research informs our assessment of the potential long-term free cash flows of the business. When we see dramatic discrepancies between our assessment and the markets' current thinking about a company, we invest accordingly.

In Amazon's case, we looked at the size of its current and potential markets and found it was still capturing only a minute portion of the latter—a fact we believed the market was vastly underestimating. At the time, retail spending in the U.S. amounted to $4.3 trillion a year, whereas Amazon was generating annual revenue of only $61.1 billion. We looked at the U.S. Census Bureau's Annual Retail Trade Survey and subtracted out each sector Amazon wasn't competing in at the time—for example, $746 billion for motor vehicles and parts dealers, $581 billion for food and beverage stores, $222 billion for pharmacies and drug stores, and other areas as well. Ultimately, we concluded that Amazon was capturing a mere 1.7% of the U.S. market at the time—and that was after subtracting many market segments the company would eventually enter, and without considering its (quite sizable) international efforts.

Bottom line: despite its robust revenue growth, Amazon still had a massive market it could potentially capture.

Ultimately, it was *the way we viewed Amazon's long-term prospects* that set us apart from most other investors and allowed us to capitalize on the opportunity. As you will see in the analysis below, the key elements of our thesis back then are still present today. We believed Amazon was significantly undervalued for four main reasons:

1) **Superior Offering**: convenience, selection, cost, personalization, customer service
2) **Massive Moat**: dominant position, significant barriers to entry
3) **Extremely Large Markets**: continued long-term growth opportunities
4) **Excellent Management**: entrepreneurial, bold, proven

Superior Offering

The first factor that made Amazon a compelling investment in 2009—and continues to make it a valuable investment today—is this: the value proposition of its offering is inherently superior to that of the traditional incumbents. By harnessing the power of the internet, a good distribution infrastructure, and continuous data-informed improvements, Amazon is able to offer consumers:

- Vast selection: Amazon's stock is not limited to the constraints of a physical store; it sells directly from huge warehouses and enlists a massive network of sub-vendors.
- Convenience: Consumers can browse from the comfort of their home—or wherever they are—and make purchases with just a few clicks of a button on their computer or smartphone.
- Time saved: Customers can shop in minutes rather than taking the time to drive to a store, shop, and drive home again. One-click purchasing streamlines the process even more.
- Shopping History: Amazon maintains easy-to-access, pictorial records of each customer's orders, making reordering a breeze.
- Customer Service: Liberal return policies and a streamlined returns process help ease customers' initial reservations about shopping online (concerns that have eased considerably since 2009).

- Lower prices: Perhaps its most important attribute, Amazon leverages fixed costs and the power of the internet to offer low prices most companies can't compete with.
- Free shipping: Offered on many products, this option adds greatly to customer appeal.
- Personalization: By analyzing each customer's purchasing and browsing behavior, Amazon can offer personalized product recommendations, enhancing the shopping experience
- Reviews: Customers can read reviews by other customers before buying a product and can write reviews as well, which offers a sense of customer empowerment.
- E-products: Amazon is transforming the publishing and entertainment industries by offering the greatest centralized selection of digital-only products such as Kindle books, audiobooks, and movie rentals/purchases.

With an almost infinitely greater selection than any physical retail store, the convenience of buying with the click of a button, ever-quicker shipping speeds (along with free 2-day shipping with Prime), the personalization features of an online store, digital-only products, and Amazon's ever-greater scale contributing to lower prices, Amazon's value proposition is simply superior to that of traditional shopping. It is impossible to imagine how brick-and-mortar stores can win this battle over the long term.

Massive Moat

In our investment process, the most important requirement is the presence of a durable economic moat. This gives the company a sustainable competitive advantage over its competitors, as well as ongoing growth potential, allowing it to consistently generate healthy returns for stockholders. We believe one would be hard pressed to find a company with a stronger economic moat than Amazon.

With over 40% market share in both the e-commerce and public cloud markets, Amazon is a truly dominant, and growing, force. The likelihood of competitors taking share from Amazon is very low for the foreseeable future. There are a number of reasons for this, five of which we will touch on here:

1) The capital needed to replicate Amazon's fulfillment networks, data centers, and technology infrastructure would be absolutely staggering. To give you an idea, in Jeff Bezos' recent shareholder letter, he noted that the company has invested *over $150 billion* worldwide in its infrastructure—*and that is just since 2011!* With over 140 fulfillment centers, over 60 sortation and delivery stations, and a continuously increasing level of investment, the company's competitive moat will only continue to increase, widening the gap between it and any possible competition. For example, Amazon added 27 fulfillment centers in 2017 alone.

2) Amazon's Marketplace has a strong network effect: because millions of consumers come to Amazon to search for products, more sellers want to sell there. This leads to a larger product selection, which, in turn, leads to more consumers coming to the site to shop. This virtuous cycle will continue to intensify, representing a monumental barrier to entry.

3) As a result of years of testing, feedback, and execution, the company has accumulated substantial data on consumers and on how to optimize a website to maximize revenue and consumer satisfaction. The ability to personalize a unique webpage for each customer serves as a competitive advantage that has no real counterpart in the brick-and-mortar world (think Walmart, Sears, etc.) and is difficult for other online retailers to replicate.

4) Operational efficiency and execution. Amazon has built its competitive moat by executing a difficult strategy at an extremely high level and continually improving processes and maximizing efficiencies. Because the retail industry runs on thin margins, success in the field requires superb execution. Amazon, at its current scale and efficiency level, is able to operate on very small margins, but imagine how difficult it would be for a smaller, less efficient up-start to do so, especially if it wanted to come close to the prices, selection, and customer service offered on Amazon.

5) If the aforementioned reasons weren't enough to deter competitors, Amazon executes an "everyday low prices" strategy. This is similar to the strategy Walmart and Costco have employed successfully, albeit on a different platform (online). Amazon uses its massive scale to pass on its cost-savings to consumers, using "everyday low prices" as a marketing strategy. Although this approach sacrifices revenue in the short-term, it deepens Amazon's economic moat, leading to higher long-term free cash flows.

Extremely Large Markets

It is rare to find a company that can compete effectively in two extremely large markets. In Amazon's case, however, you have a company that is not only *competing* in two massive markets, but is *dominating* in both: retail and public cloud infrastructure. Retail sales in the U.S. neared $5 trillion in 2017. Meanwhile, market-intelligence firm IDC predicts an overall IT budget of $2.7 trillion, and a public Cloud market of $236 billion, by 2020. With over 40% market share *in each market*, Amazon is poised to continue to grow at healthy rates for numerous years.

And the growth opportunities remain expansive. Although it may seem as if e-commerce has already taken over the world, this platform represents, surprisingly, only 9% of total U.S. retail sales. With the inherent advantages Amazon offers over traditional retailers, and the still-growing acceptance of e-commerce by the retail public, Amazon will continue to pull share from brick-and-mortar locations for many years. To this day, Amazon's online market share is still *accelerating*, recently reaching 44%.

In the Cloud services domain, Amazon has a high-margin and industry-dominant business that also enjoys a multi-year tailwind due to characteristics superior to those of competitors in the private server market. AWS is already a $20 billion Revenue Run Rate business, having reached $10 billion in annual sales in only 10 years, and its revenue growth is *accelerating* at this scale. Just as in e-commerce,

Amazon is the undisputed leader in this market, with over 40% market share. For perspective, Microsoft, Google, and IBM together account for 23% of the market.

Between retail and the Cloud, Amazon has two massive markets in which it will continue to grow for years to come. In its most recent quarter, the company reported a revenue increase of *43%* year-over-year! To have a company at this scale—$193 billion in annual revenues—growing at that rate is truly mind-boggling, perhaps unprecedented. These results are reflective of Amazon's superior offerings, massive economic moat, and unparalleled execution.

Excellent Management

Jeff Bezos has exhibited a tremendous ability to lead an organization, growing the company from its founding to one of the largest enterprises in the world. Having a proven founder still leading a company as its CEO is an invaluable asset. Moreover, his substantial ~17% stake in the company further aligns his interests with those of shareholders. Bezos, the management team, and all the departmental teams in the company have proven themselves to be excellent operators as evidenced by the company's dominance in not one, but two, industries in such a short period of time. It's easy to forget Amazon was founded just 24 years ago!

The company's "Obsess Over Customers" culture has permeated the organization, which has allowed it to focus on serving customers and innovating on behalf of them. Furthermore, Bezos has shown the ability to be bold, when warranted, and take smart risks, with his purchases of Kiva Systems (warehouse robotic systems), Twitch (leading live-streaming gaming platform, which is growing rapidly), Whole Foods Market (providing optionality in the massive groceries market), and many other bold acquisitions. This entrepreneurial and inventive spirit has been foundational to Amazon's success thus far.

Thinking Differently

Ultimately, Prime Opportunities' competitive advantage—like Amazon's—lies in *thinking differently*. What are some ways we thought differently about Amazon, relative to the general consensus, in 2009 (and continue to think differently today)? Here we present two of the theories that were prevalent at the time, followed by our opposing view and the reasoning and logic behind our thinking.

Prevailing View #1**: With a P/E ratio of 66, and a low profit margin, Amazon is overvalued! How can one find value in a company with such a high valuation?**

Our View: Here we think investors missed the point—and continue to miss the point today. Using an income statement as the sole way to value a company has several flaws. For all the benefits of accrual-based accounting (matching revenues and expenses, etc.), there are also drawbacks to this method. For one, the actual cash flows of the business—the factor that really matters—are not reflected. Additionally, the method does not accurately reflect a company's potential. Two very different

companies—one that is investing for growth and one that is not—both have to present a similarly formatted income statement. It is then up to investors to research each company, discern the level of investment, and assess the businesses' true earnings power.

To illustrate the point: With a net margin of 2%, what happens to net income if the profit margin increases by 6% (600 bps)—assuming the company decreases its level of investment? That's right: net income increases 4x! This would effectively bring the "P/E" (as reflected by the income statement) down to 16.5. The point is that one needs to analyze the true free cash flow generation capabilities of the business, how much the company is investing for growth, and—of utmost importance—the return-on-capital one would expect those investments to yield over the long-term.

In Amazon's case, it has been investing heavily for growth for numerous years. The company has consistently chosen to maximize its investments in high-return areas—which has continually deepened its competitive moat and maximized long-term free cash flows.

***Prevailing View #2*: Amazon is a technology company, and technology is extremely risky to invest in.**

Our View: We generally agree that "technology" companies tend to carry high risk, and are therefore risky investments. However, "technology" is a very broad term. As always, at Prime we like to dig into the facts and accurately assess the situation, regardless of whatever popular shorthand analyses and jargon are being tossed about by the media, the pundits, or the general public.

When referring to technology in the generally accepted sense of the term, investors are typically referring to fast-changing products and services that revolve around new developments in the computer and telecommunications arenas—markets and fields where today's standards can quickly become obsolete, thereby rendering an investment worthless. Although this characterization accurately describes many companies, there are many other companies routinely grouped under the rubric of "technology" that don't fit this criterion.

Amazon is one such case. Although one can say it is a "technology" company because it uses a website as its storefront, in our view Amazon is simply *using* technology to provide a basic human function—retail shopping. Furthermore, by *leveraging* its technology, it is able to fulfill this human need in a tremendously more compelling way than traditional methods—as we touched on above. When looking at Amazon, rather than thinking, "This is technology, we should stay away" as many investors did, we analyzed the company and came to the conclusion that it simply offered a vastly better service, and enjoyed a massive moat because of that service. Technology is just its tool. As technology changes, Amazon will no doubt use that changing technology to its continuing advantage.

What's especially noteworthy about this thesis is that we've maintained it for over eight years – *way before* there was a general consensus that Amazon was a dominant force in the industry. In fact, we actually started forming these opinions on Amazon even before we invested in December 2009. As noted in our 2012 annual letter, we wrote a letter to Warren Buffett in 2008, in response to his

advertised opening for an investment manager. In the letter – excerpts of which are available upon request – we discussed our views on the definition of "tech" and on Amazon's prospects.

At the time, Amazon's future was hotly debated. In those years—both in 2008 and in 2009 when we invested based on the conclusion that Amazon was undervalued—most fund managers steered clear from the company, viewing it as an extremely risky play. Now, after our thesis has played out, the pendulum has swung almost to the extreme opposite end of the spectrum. It has reached a point where operational managers, analysts, investors, and media pundits are speaking about Amazon perhaps more than any other company. To give you an indication of Amazon's dominance, Reuters examined the quarterly conference calls of all companies in the U.S. in 2017 and found that nearly *700* companies mentioned Amazon during their earnings calls.

The bottom line: only by **accurately assessing Amazon's long-term prospects** *back in 2009*, when others were missing the boat, were we able to reap the benefits of a 30.9% compounded annual gain in the stock.

Rigorous Research: The Bedrock of Long-Term Outperformance

We hope that by delving deeper into one of our longest-held investments, we are able to provide you with more insight as to how we research companies. Although the details and factors affecting each company vary considerably, the key elements of our research *process* remain the same. We believe our commitment to rigorous research is the foundation upon which we've averaged 26.72% per year (Long Only Unlevered, net). As we look forward, we will remain steadfast in our commitment to focusing on the long-term, and we will continue to diligently manage the fund to the best of our abilities.

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PERFORMANCE AND PORTFOLIO: Prime Opportunities Long/Short Composite performance results reflect time-weighted rates of return, the reinvestment of dividends and other account earnings, and are net of applicable account transaction and custodial charges, and Prime's performance based allocation. The reinvestment of dividends and other earnings may have a material impact on overall returns. Valuation is computed and performance is reported in U.S. dollars. All Prime products are subsets of a single core portfolio, with the same securities. Returns for Ultra Hedged Levered portfolio reflect the performance of the Prime Opportunities Long/Short Composite. "Long Only Unlevered," "Long Only," "Traditional Long/Short," "Ultra Hedged Unlevered," and "Ultra Hedged 50% Cash Unlevered" performance represent the stock performance of Prime Opportunities Long/Short Composite, adjusted based on each portfolio's level of hedging and leverage. Prime has never used options on our long positions. Options on our short positions were used in the past on two securities, but have not been purchased for four years, and when bought were limited to Deep-in-the-Money LEAP puts for tax efficiency. Prime does not anticipate any use of options going forward.

Returns for Prime's Ultra Hedged Levered portfolio reflect the performance of the Prime Opportunities Long/Short Composite. Returns for subset products "Traditional Long/Short", "Ultra Hedged Unlevered", "Ultra Hedged 50% Cash Unlevered", "Long-only", "Unlevered Long-Only" are illustrated net of fees and subject to a high water mark, and do not include cash or cash equivalents. Actual long exposure of the Prime

Opportunities Long/Short Composite used for all products, with the following maximums: Ultra Hedged Unlevered and Long-Only Unlevered: 100% long exposure; Ultra Hedged 50% Cash Unlevered: 50% long exposure; Traditional Long/Short: 125% long exposure. Actual net exposures of the Prime Opportunities Long/Short Composite used for all Long/Short products with the following exception: Returns for Traditional Long/Short are illustrated using actual net exposures of the Prime Opportunities Long/Short Composite through July 2010, with 125% long exposure and 60% short exposure thereafter; the Prime Opportunities Long/Short Composite first surpassed 125% long exposure in July 2010. Floor for all products: 0% short exposure. Gross returns for subset products were calculated on a monthly basis using figures from the Composite as follows: ((Product long exposure / Composite long exposure) * Composite long contribution)) + ((Product short exposure /Composite short exposure) * Composite short contribution)). Net returns of subset products represent actual fees of the Prime Opportunities Long/Short Composite product, and were calculated using the Prime Opportunities Long/Short Composite gross return to net return ratio.

"Long-only performance" as illustrated in this report represents the long only stock performance of the Prime Opportunities Long/Short Composite. Returns were reduced by a simulated incentive fee of 20% of all profits, charged quarterly through 12/31/13, represent actual fees of the Prime Opportunities Long/Short Composite through 12/31/14, and represent actual product fees thereafter.

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COMPOSITE DEFINITION AND RISKS: The Prime Opportunities Long/Short composite includes U.S. and international securities which utilizes a fundamental stock selection process. This process is combined with rigorous risk control to create an attractive return/risk product. The portfolio's value added is a function of the return spread between the long and short portfolios with the goal of providing long-term capital growth from a well-hedged strategy. Positions in the underlying portfolios are leveraged at a ratio up to, but not limited to, 2:1 for long positions and 2:1 for short positions.

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