

# T2 Partners LLC

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Dear Partner,

Our fund declined 2.8% in January vs. gains of 2.4% for the S&P 500, 2.9% for the Dow and 1.8% for the Nasdaq.

Our long book actually beat the market in January largely due to Grupo Prisa (the A shares rose 34.0% and the B shares rose 16.4%), but we gave back all of these gains and then some thanks to significant losses on the short side, led by St. Joe (up 25.4%) and Netflix (21.8%) (both discussed below).

## Our Recent Performance

Over the last five months, our fund has declined by 4.3% net, which, in isolation, isn't a terrible number. For perspective, since inception just over 12 years ago we've had 16 *months* worse than this – and let's not even talk about October 2008 through February 2009. Now *that* was painful!

But given that the S&P 500 has surged 23.5% over the last five months, this has been, by far, our worst relative performance in our history. While we are focused, first and foremost, on absolute returns and preserving capital, missing such a big move is very disappointing and led us to carefully evaluate what went wrong so we can identify our mistakes and fix them.

## Repositioning Our Short Book

As we've discussed in prior letters, our underperformance is due almost entirely to our short book, so we've been thinking hard about it, both in terms of stock selection and also how we size it. We've come to the following conclusions:

### *Stock selection*

Over time we've been quite successful shorting fads, frauds, promotions, declining businesses, and bad balance sheets. Where we have had much less success, however, especially in recent months, is shorting good businesses that are growing rapidly, even when their valuations appear extreme. Such open-ended situations, regardless of valuation, are very dangerous, so going forward we will avoid them entirely unless we have a high degree of conviction about a specific, near-term catalyst.

### *Sizing our short book*

A far bigger mistake we made was maintaining a large short book even after the crisis had passed. Allow us to explain why this occurred by starting with some background: From 2003 through 2007, our typical portfolio positioning was 80-100% long and roughly 20% short. In early 2008, when we became convinced that the housing market would collapse, we tripled our short book to around 60%, with an emphasis on highly leveraged housing, real estate, and

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financial companies that were most exposed to the subprime bubble. Needless to say, this worked out spectacularly well – so well, in fact, that we became accustomed to running a short book in the 50-70% range and – we’re embarrassed to admit – we pushed to the back of our minds two facts that have always been true: 1) shorting is a terrible business (as we highlighted in our [book](#)), and 2) we’re much better long investors than short investors. Said another way, long investing is a massively better business than shorting, plus our experience, skill set and temperament is much better suited to it. We will not forget this again.

What we are best at – and what has accounted for our long-term outperformance – is the ability to identify cheap stocks and special situations such as the four that drove our returns in 2010: General Growth Properties (in bankruptcy), Berkshire Hathaway (a safe blue chip with the catalyst of being added to the S&P 500), Liberty Acquisition Corp. (illiquid warrants, betting on a merger going through), and BP (horrible headlines and bankruptcy fears).

To be clear, our conclusion isn’t to abandon short selling altogether. Done very carefully and selectively, in limited size, we are confident that our short book can provide both hedging and positive returns. But at most times we will have a short book in the 25-40% range.

Keep in mind that if the market tumbles and stocks are cheap across the board, as they were in early 2009, we’ll likely have a smaller short book. Conversely (and far more likely, in our opinion), if the market or certain sectors become very overvalued and we become convinced that the fundamentals are about to fall apart, we won’t hesitate to increase our short book substantially, as we did in early 2009.

Over the past dozen years, there have been two periods in which it was an exceptionally good time to short stocks. The rest of the time, however, even the best short sellers found it difficult to make money. While we have no ability to predict short-term market gyrations, we have proven adept at identifying enormous, obvious bubbles: for both the internet and housing/credit bubbles, we publicly identified them as bubbles before they burst and took steps to protect our portfolio. Equally importantly, in the aftermath, we publicly identified when stocks had become cheap and profited from the rebound.

While our outlook today is cautious, for reasons we outlined in our annual letter, we do *not* think that we are currently on the brink of a major market and economic decline. Rather, we think the most likely scenario is that the U.S. economy will muddle through and slowly get better over the next few years. If so, it will likely not be a good time for short selling and hence we have reduced our short exposure.

In summary, we are redoubling our focus on what we do best – buying cheap stocks – and are deemphasizing short selling – both in terms of time and capital. Still, we are always keeping a close eye out for the occasional big bubble that might give us the opportunity to make a lot of money on the short side.

## Microsoft

We have recently been adding to Microsoft and Berkshire Hathaway, which are now our two largest positions. Microsoft reported blowout earnings last week, far exceeding analysts’ estimates, as revenues, operating income, and earnings per share rose 15%, 20% and 28%,

respectively. The balance sheet is Fort Knox, with net cash exceeding \$31.5 billion (\$3.68/share), and the company bought back \$5.1 billion of stock during the quarter, at which rate Microsoft will retire about 8% of its shares annually. Finally, the stock, at \$24.05 net of cash, trades at a mere 10.1x trailing EPS and 9.3x consensus analysts' EPS estimates for the next 12 months (which we think are much too low).

Despite all of this, the stock fell after Microsoft announced earnings, due no doubt to the consensus view that Microsoft is a fading giant, doomed to a future of lower market share, sales, margins and profits. It is of course possible to concoct such a scenario – people have been doing it for well over a decade – but *there is no current evidence to support it*. Microsoft's market share in its key business areas is stable or rising, and sales, margins and profits are growing nicely.

We think there is robust growth in the store for Microsoft, as numerous areas of its business are booming. Most notably, while the company has now sold over 300 million Windows 7 licenses, the operating system is running on only slightly more than 20% of the world's internet-connected PCs, so there is huge embedded growth here.

### Berkshire Hathaway

We recently updated our Berkshire Hathaway slide deck and have posted it at [www.tilsonfunds.com/BRK.pdf](http://www.tilsonfunds.com/BRK.pdf). We have increased our estimate of intrinsic value to \$160,000 per A share, more than 30% above today's price, due to the enormous surge in profits from Berkshire's operating businesses, driven by a recovering economy and the acquisition of Burlington Northern. This, plus the roughly \$6 billion in stock gains in Q4 and reversal of market-to-market derivatives losses from earlier quarters will, we believe, result in an exceptionally strong Q4 earnings report later this month.

### St. Joe Company

In light of St. Joe's big move up, we have revisited our analysis of the company and we still believe that it's 3-4x overvalued. St. Joe is most emphatically not an open-ended growth situation (though the stock has been acting like it recently). To the contrary, the company is burning cash and time is working against it.

To give you an idea of how disconnected from reality its shares are, when the company disclosed in early January that the SEC "is conducting an informal inquiry into St. Joe's policies and practices concerning impairment of investment in real estate assets," the stock, after falling at first, finished the day *up* (and rose an additional 17.7% over the rest of the month).

If you wish to learn more about the company and the bearish case for the stock, we suggest that you [read and listen](#) to David Einhorn's 139-slide presentation which he presented at the Value Investing Congress on October 13<sup>th</sup>. It's an exceptional piece of analysis, and our short thesis mirrors his.

### Netflix

Since we first wrote to you in December about our Netflix short position, we have received quite a bit of new information including results from our [survey](#), input from investors, and the

company's recent earnings release. We are still digesting this information, which has both bullish and bearish implications, and will write to you about our conclusions in the near future.

### Conference Call

On January 11<sup>th</sup> we hosted our quarterly conference call, during which we discussed many of our long and short positions as well as how we're adjusting our overall portfolio positioning.

To listen to the 90-minute call via phone, dial (712) 432-1280, enter access code 1023274#, and hit 5# when you hear the recording. Alternatively, you can download the audio file here:

<https://download.yousendit.com/bFIGZGlqSEJCTWxjR0E9PQ> (this is a .wav file; if you're on a Mac and prefer an MP3 file, click here:

<https://download.yousendit.com/bFIGZGlzNDJrWSt4dnc9PQ>).

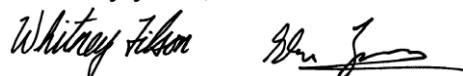
### Conclusion

In their latest *Kiplinger's* column, [6 Blue-Chip Stocks on Sale](#), John Heins and Whitney write:

Don't be enticed into a sucker's game of chasing the hottest stocks, and instead invest in high-quality, blue-chip companies with global businesses, powerful brands and market positions, strong cash flows, rock-solid balance sheets and healthy dividends. Normally, you have to pay a rich price for such high-quality businesses, but today quality is on sale. We can't explain why, but are happy to take advantage of it.

Thank you for your continued confidence in us and the fund. As always, we welcome your comments or questions, so please don't hesitate to call us at (212) 386-7160.

Sincerely yours,



Whitney Tilson and Glenn Tongue

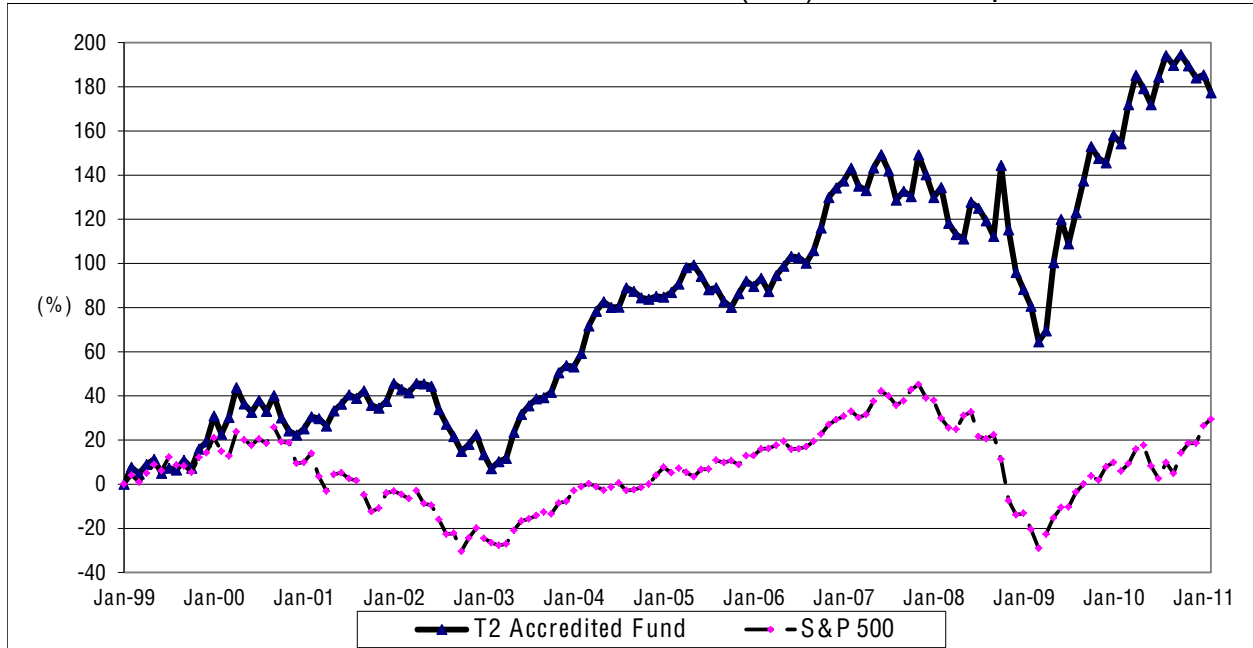
The unaudited return for the T2 Accredited Fund versus major benchmarks (including reinvested dividends) is:

	<u>January</u>	<u>Since Inception</u>
T2 Accredited Fund – gross	-2.8%	251.3%
T2 Accredited Fund – net	-2.8%	177.3%
S&P 500	2.4%	29.5%
Dow	2.9%	70.4%
NASDAQ	1.8%	27.1%

Past performance is not indicative of future results. Please refer to the disclosure section at the end of this letter. The T2 Accredited Fund was launched on 1/1/99. Gains and losses among private placements are only reflected in the returns since inception.

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## T2 Accredited Fund Performance (Net) Since Inception



## T2 Accredited Fund Monthly Performance (Net) Since Inception

	1999		2000		2001		2002		2003		2004		2005		2006		2007		2008		2009		2010		2011	
	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500	T2 AF	S&P 500
January	7.8	4.1	-6.3	-5.0	3.5	3.6	-1.8	-1.5	-4.4	-2.6	4.7	1.8	1.2	-2.4	1.9	2.7	2.4	1.7	1.9	-5.9	-3.6	-8.4	-1.6	-3.6	-2.8	2.4
February	-2.9	-3.1	6.2	-1.9	-0.5	-9.2	-1.1	-2.0	2.3	-1.6	7.0	1.5	2.1	2.0	-3.1	0.2	-3.3	-2.1	-6.8	-3.3	-8.8	-10.8	7.3	3.1		
March	4.1	4.0	10.3	9.8	-2.1	-6.4	3.8	3.7	1.1	0.9	3.9	-1.5	3.9	-1.7	3.9	1.3	-0.8	1.1	-2.3	-0.5	2.9	9.0	4.6	6.0		
April	2.1	3.7	-5.1	-3.0	4.4	7.8	-0.2	-6.0	8.4	8.2	2.4	-1.5	0.7	-1.9	2.2	1.4	4.4	4.6	-0.9	4.9	18.2	9.6	-2.1	1.6		
May	-5.7	-2.5	-2.8	-2.0	1.8	0.6	0.0	-0.8	5.4	5.3	-1.4	1.4	-2.6	3.2	1.8	-2.9	2.5	3.3	7.9	1.2	6.5	5.5	-2.6	-8.0		
June	2.2	5.8	4.1	2.4	4.8	-2.4	-7.3	-7.1	2.4	1.3	0.1	1.9	-3.1	0.1	-0.3	0.2	-3.0	-1.5	-1.2	-8.4	-4.2	0.2	4.5	-5.2		
July	-0.7	-3.2	-3.6	-1.6	-0.1	-1.0	-5.0	-7.9	1.9	1.7	4.6	-3.4	0.5	3.7	-0.9	0.7	-5.4	-3.0	-2.5	-0.9	5.6	7.6	3.5	7.0		
August	4.1	-0.4	5.4	6.1	2.5	-6.3	-4.3	0.5	0.4	1.9	-0.9	0.4	-3.2	-1.0	2.9	2.3	1.7	1.5	-3.3	1.3	5.3	3.6	-1.5	-4.5		
September	-3.3	-2.7	-7.2	-5.3	-6.1	-8.1	-5.4	-10.9	1.4	-1.0	-1.6	1.1	-1.5	0.8	5.0	2.6	-1.1	3.6	15.2	-9.1	6.2	3.7	1.7	8.9		
October	8.1	6.4	-4.5	-0.3	-0.8	1.9	2.8	8.8	5.9	5.6	-0.4	1.5	3.5	-1.6	6.3	3.5	8.2	1.7	-12.0	-16.8	-2.0	-1.8	-1.7	3.8		
November	2.8	2.0	-1.5	-7.9	3.0	7.6	4.1	5.8	2.3	0.8	0.8	4.0	3.1	3.7	1.9	1.7	-3.6	-4.2	-8.9	-7.1	-1.2	6.0	-1.9	0.0		
December	9.8	5.9	2.3	0.5	6.5	0.9	-7.4	-5.8	-0.4	5.3	-0.2	3.4	-1.3	0.0	1.4	1.4	-4.3	-0.7	-4.0	1.1	5.7	1.9	0.5	6.7		
YTD TOTAL	31.0	21.0	-4.5	-9.1	17.6	-11.9	-20.5	-22.1	29.4	28.6	21.0	10.9	2.6	4.9	25.2	15.8	-3.2	5.5	-18.1	-37.0	31.9	26.5	10.5	15.1	-2.8	2.4

T2 Accredited Fund, LP (the “Fund”) commenced operations on January 1, 1999. The Fund’s investment objective is to achieve long-term after-tax capital appreciation commensurate with moderate risk, primarily by investing with a long-term perspective in a concentrated portfolio of U.S. stocks. In carrying out the Partnership’s investment objective, the Investment Manager, T2 Partners Management, LLC, seeks to buy stocks at a steep discount to intrinsic value such that there is low risk of capital loss and significant upside potential. The primary focus of the Investment Manager is on the long-term fortunes of the companies in the Partnership’s portfolio or which are otherwise followed by the Investment Manager, relative to the prices of their stocks.

There is no assurance that any securities discussed herein will remain in Fund’s portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed may not represent the Fund’s entire portfolio and in the aggregate may represent only a small percentage of an account’s portfolio holdings. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. All recommendations within the preceding 12 months or applicable period are available upon request.

Performance results shown are for the T2 Accredited Fund, LP and are presented gross and net of incentive fees. Gross returns reflect the deduction of management fees, brokerage commissions, administrative expenses, and other operating expenses of the Fund. Gross returns will be reduced by accrued performance allocation or incentive fees, if any. Gross and net performance includes the reinvestment of all dividends, interest, and capital gains. Performance for the most recent month is an estimate.

The fee schedule for the Investment Manager includes a 1.5% annual management fee and a 20% incentive fee allocation. For periods prior to June 1, 2004, the Investment Manager’s fee schedule included a 1% annual management fee and a 20% incentive fee allocation, subject to a 10% “hurdle” rate. In practice, the incentive fee is “earned” on an annual, not monthly, basis or upon a withdrawal from the Fund. Because some investors may have different fee arrangements and depending on the timing of a specific investment, net performance for an individual investor may vary from the net performance as stated herein.

The return of the S&P 500 and other indices are included in the presentation. The volatility of these indices may be materially different from the volatility in the Fund. In addition, the Fund’s holdings differ significantly from the securities that comprise the indices. The indices have not been selected to represent appropriate benchmarks to compare an investor’s performance, but rather are disclosed to allow for comparison of the investor’s performance to that of certain well-known and widely recognized indices. You cannot invest directly in these indices.

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