April 12, 2019

Dear Partner:

2019 has started off on a good note. The Greenlight Capital funds (the "Partnerships") returned 11.0% for the quarter, almost reversing the loss in the fourth quarter of 2018. The S&P 500 returned 13.6%, which also almost reversed its fourth-quarter 2018 result.

Nonetheless, it continued to be a challenging environment for our investment style with growth stocks performing much better than value stocks. In the context of this headwind and a sizable short portfolio, we are pleased with the quarterly result.

Last year we only had one position contribute more than 1% to our performance. This quarter we had eight winners that large. Of the six longs we wrote about at year-end, five – AerCap Holdings (AER), Brighthouse Financial (BHF), Deutsche Pfandbriefbank (Germany: PBB), General Motors (GM) and Green Brick Partners (GRBK) – were the biggest gainers. We also had significant gains in Altice USA (ATUS), Tempur Sealy International (TPX) and on our Tesla (TSLA) short. While we did a good job in reducing our short exposure to the most volatile names during the fourth-quarter dip, we still experienced losses on our short Assured Guaranty (AGO)/long Puerto Rico GO bonds position, the Bubble Basket short, and Netflix (NFLX) puts. Overall, our longs performed a little better than the market, our shorts lost money but went up much less than the market, and macro made a small profit.

Even so, most of the moves appeared to be driven by the market rather than company-specific news. Two exceptions were BHF and TSLA. While GM announced a strong result and gave surprisingly strong guidance, it wasn't enough to drive more than a market return.

BHF's GAAP accounting is difficult for many investors to understand. Essentially, the company purchases hedges to mitigate its exposure to equity market and interest rate risks. Under GAAP accounting, the hedges get marked to market each quarter, but the liabilities they hedge do not. This creates a mismatch between how BHF's assets and liabilities are treated in response to market moves. All else being equal, BHF benefits from rising equity markets and higher interest rates, as the economic gain from lower expected claims more than offsets the company's losses on its hedges. However, the company's GAAP accounting indicates the opposite; while the hedges generate mark-to-market losses, there is not a corresponding reduction in GAAP liabilities.

As a result, when markets rose in the first part of 2018, BHF's GAAP results showed losses and book value declined. The company presents adjusted earnings that correct for the perverse accounting treatment, but we believe the GAAP losses dissuaded many investors from buying the shares last year. Some analysts even pointed to BHF's declining book value as evidence that the company would perpetually lose money.

2 Grand Central Tower • 140 East 45 th Street, 24 th Floor • New York, NY 10017 Phone: 212-973-
1900 • Fax 212-973-9219 • www.greenlightcapital. com

BHF's fourth-quarter results and earnings call should dispel this misunderstanding. In the fourth quarter of 2018, the dynamic reversed; equity markets and interest rates fell – a negative for the business but a positive for the hedges. The result was that BHF reported a GAAP profit of more than $12 a share for the quarter. Obviously, we don't believe this reflects the company's earnings power, but it undermines the bearish argument that the company is saddled with GAAP losses. If anything, the result suggests that adjusted profits are a better indicator of BHF's performance. On that basis, BHF earned $7.44 per share in 2018 and we expect it will earn about $9 per share in 2019.

BHF intends to repurchase $1.5 billion of stock by the end of 2021, which would be more than one-third of its market capitalization. When management made the announcement, skeptics questioned whether the company could obtain sufficient dividends from its regulated insurance subsidiaries to meet that goal. We were pleasantly surprised when the year-end financials revealed nearly $1 billion of permitted dividend capacity from the subsidiaries in 2019 alone. While there remain some scenarios in which BHF could fail to meet its buyback target, we believe the chances of achieving it have improved considerably. Though the shares appreciated from $30.48 to $36.29 during the quarter, we believe they remain considerably undervalued at around 4x 2019 adjusted earnings and 30% of year-end book value.

Turning to TSLA, the wheels are falling off – literally. Some TSLA cars have faulty suspensions, such that the wheels sometimes fall off (referred to as "whompy wheels"). On February 24, a man driving in Davie, Florida, was tragically killed inside his Model S after hitting a tree, his front driver-side wheel severed from the wreck. The car battery caught fire, and neither the driver nor first responders could open the doors, which were locked shut with the door handles retracted.[1]

TSLA routinely touts its cars as the safest around, because they perform well in crash tests. The truth is, its overall safety is much lower because of events like this. TSLA's inaptly-named features including "Enhanced Autopilot" and "Full Self-Driving" appear to contribute to the safety issue as they create consumer misperception of the cars' capabilities.[2] The fatality rate for TSLA drivers is much higher than it is for other luxury cars.

We recall the public concern when a handful of Samsung Galaxy phones spontaneously combusted in 2016. By way of comparison, a few people suffered burns, and there were no fatalities. Nevertheless, this led to a recall of millions of phones and a variety of new safety rules. When Uber had a single fatality in its self-driving program in 2018, it suspended the program for nine months only to resume it with enhanced safety protocols. Recently, GM, Ford and Toyota announced a consortium to establish safety rules for development, testing and deployment of autonomous vehicles. TSLA was notably absent from that group and continues

[1] This despite Elon Musk's assertion via tweet on January 26, 2019, "All doors unlock automatically when the Tesla comes to a stop after an accident. There is both primary & backup power to doors, brakes, steering & airbags."

[2] TSLA also reports data on crash frequency per mile driven both with and without Autopilot and with comparisons to national averages. The comparisons are inherently misleading because Autopilot is mostly used on highways, where accidents in general are much less frequent.

to use its customers and other motorists, bikers and pedestrians sharing the roads with distracted or sleeping Tesla drivers as guinea pigs.

As for its operating performance, TSLA is in a difficult position. When 450,000 people made reservations to buy a Model 3 a couple of years before its launch, TSLA may have been constrained by its ability to produce enough cars to meet demand. Starting in 2019, that is no longer the case. While Elon Musk promises annual global demand of 500,000 to 700,000 Model 3's, the reality is quite different. U.S. sales for the Model 3 fell about two-thirds in the March quarter from the December quarter, as the demand from the enthusiastic portion of its customer base has already been satisfied. If Q1 is any indication, total annual global demand for the Model 3 is about 200,000 vehicles. We believe that TSLA's poor reputation for quality and service and diminishing tax incentives are limiting broader demand.

Moreover, some combination of the availability of the cheaper Model 3 and emerging competition from Jaguar, Audi, Kia, Hyundai and others has crushed the demand for TSLA's established high-end Model S and Model X. TSLA has responded with large price cuts, which to date have only generated minimal incremental demand. In 2018, the Models S and X contributed over $2.5 billion of gross profit. Given the price cuts and reduced demand, we believe TSLA will be lucky to achieve even $1 billion of gross profit from those models this year.

The price cuts are also likely to have a significant impact on TSLA used car prices, to which TSLA has large exposure through its leasing program. When TSLA cars come off lease, TSLA appears to be reluctant to resell them, as used Model S's and X's compete with new Model 3's, which have their own demand problems. Used Model S's and X's appear to be piling up in parking lots across the country.

The price cuts have also led to aggressive new lease terms. For example, in late March we found a TSLA payment estimator for a three-year lease on a 2018 Model S P100D for $7,000 down and $412 per month. This car was listed for about $135,000 in 2018. On the payment estimator, the new car price is now about $86,000 with an estimated residual value of over $74,000. As a general principle, used cars don't retain 85% of their original price after three years. We wonder how TSLA's leasing partners are evaluating the impact of the price cuts.

All told, even with the price cuts, TSLA only sold 63,000 cars in the first quarter – a quarter in which it benefitted from the introduction of the Model 3 into China and Europe and of lower-priced variants in the United States. Product introductions generate a surge of demand from enthusiasts, just as a new oil well starts with flush production. After the initial surge, demand deteriorates. American surge demand for the Model 3 happened in 2018 and European and Chinese surge demand was mostly satisfied in the first quarter of 2019.

TSLA is still guiding to quarterly demand of about 100,000 to 115,000 cars for the balance of the year. We don't see what can possibly drive that much demand. In fact, we suspect that without initial surge demand elsewhere, TSLA will struggle to even maintain first quarter unit volumes.

In addition to lower revenues and profits, the reduced demand creates another problem for TSLA: should car sales fall materially short of TSLA's estimates, TSLA's commitment to purchase batteries from Panasonic could become a big problem. Although TSLA does not disclose the details, we can make some assumptions: we estimate that TSLA must purchase about $3 billion of batteries from Panasonic in 2019. If the average TSLA has a 70 kWh battery (based on a mix of Models 3, S and X) and TSLA pays $120 per kWh, the average battery cost per car would be $8,400. On that basis it would take about 360,000 cars to absorb a $3 billion commitment. A more realistic 250,000 cars would create a $900 million shortfall.

In the history of TSLA, there have been a number of times where Musk has reflected backward and admitted that the company was on the brink of failure, before he rescued it. This happened as recently as November 2018 when Musk admitted that TSLA was bleeding money like crazy and within "single-digit weeks" of failure during the troubled ramp-up of the mass-market Model 3.

However, Musk never admits the crisis in real time. We believe that right here, right now, the company appears to again be on the brink. The signs are everywhere, from the lack of demand, desperate price cutting, layoffs, closing-and-then-not-closing stores, closing service centers, cutting capex, rushed product announcements and a new effort to distract investors from the demand problem with hyperbole over TSLA's autonomous driving capabilities. TSLA has lost a significant number of senior executives and appears to be having a hard time recruiting replacements. After all, who would want to work in such an environment?

Last summer, Musk promised TSLA would be profitable and cash flow positive in every quarter going forward. He repeated that forecast as recently as the end of January. That promise has failed to materialize. The question at hand is: in a few months will Musk be again bragging that he saved the company from the brink of failure, or will TSLA in fact fail this time? Come back at the same Bat-Time on the same Bat-Channel next quarter to get an update.

TSLA's share price declined from $332.80 to $279.86 in the quarter.

We initiated no material new long positions this quarter. We completed our exit from Bayer. Over our two-and-a-half year holding period, we made a small gain. Essentially, this investment failed at nearly every turn: the new pharma pipeline disappointed, there was fraud in the company's Brazilian operation, the FDA shut down a manufacturing facility, the consumer brands business disappointed, the Monsanto merger was completed but only after a high level of divestitures, the company raised more equity than we had hoped and finally, the company appears to face large unexpected liabilities for glyphosate, which is alleged to be a carcinogen. All told, we feel fortunate that our entry price was low enough and our trading active enough that we escaped without a loss.

We have a couple personnel developments to share.

Barrett Brown joined in February as our new CFO. Barrett was CFO of Viking Global Investors for six years before taking a few years away from the industry. Prior to Viking, Barrett was a Partner at PricewaterhouseCoopers. Barrett quickly became a fan of our TSLA short when the

company disrupted his first month-end at Greenlight by making a significant announcement after-hours on February 28. Welcome, Barrett!

Justin Lepone, our Director of Partner Relations, will be departing Greenlight in May to spend time with his family and travel extensively. In addition to leading our Partner Relations team for the past 16 years, Justin has become a friend to many of you, and we know you will miss him as much as we will. We wish Justin much happiness in this exciting next chapter for him and his family!

At quarter-end, the largest disclosed long positions in the Partnerships were AerCap Holdings, Brighthouse Financial, CONSOL Coal Resources, General Motors and Green Brick Partners. We continue to own roughly the same amount of gold, but have decided to exclude macro positions from our list of largest disclosed long positions now and going forward to be consistent with our monthly attribution reports. The Partnerships had an average exposure of 112% long and 70% short.

"Rainbows are visions, but only illusions, and rainbows have nothing to hide."

Best Regards,

Greenlight Capital, Inc.

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