Citron | CAPITAL

January 6, 2020

Annual Investor Letter for 2019

Results

In 2019, our first full year of operation, Citron Capital, LP ("Fund") generated a gross return of 56.4% and net return of 43.3%. The Fund's average exposure during 2019 was 75.8% long and 80.3% short. While we are pleased with our performance, 2019 was not as difficult for short sellers as the overall market returns might imply as the S&P's return was largely driven by a few individual stocks (e.g., Microsoft and Apple).

Our top winners on the long side included Bausch Health, RH, and Snap and on the short side included Ligand Pharmaceuticals, Jumia Technologies, and Grand Canyon Education.

Citron will never opine on the state of the actual market or where we believe returns on any asset class will be in the next 12 months as we understand our role as market participants is to react to conditions not predict them (i.e., spend more time on our process than on forecasting macro trends).

Lessons learned in 2019

#1 – Always Go Back to Citron's Proficiency – Exposing Fraud

While the Jumia story did not get the media attention it deserved, this was probably to save face for the bulge bracket investment banks who brought this company public. While initially crowned as the "Amazon of Africa," Citron thoroughly investigated and exposed a company riddled with fraud. This once $3 billion company is now down 80% since our first report.

#2 – *Stay Away from The Big Story "Cult Stocks"*

While we were fortunate not to be short Tesla in its recent surge to over $420, we had a small position in Shopify turn into a large loser as we ignored the bigger story of what we believed was an overpriced SaaS company with competition looming. Either way, going forward this type of story is too large for us to get our little hands around.

The lessons learned above have helped us craft what we believe will be our two largest contributors in 2020.

Top Picks for 2020

<u>RH Long – Price Target of $300</u>

Shopify has taught us that a category leader with a cult following can continue to go higher and higher. Citron has been a long-time bull on RH since our initial recommendation to buy the stock at $30. We believe the company has matured to a point that we might see it acquired in 2020.

Consider this, LVMH's purchase of Tiffany & Co best highlights the current luxury land grab. LVMH will acquire the luxury retailer for 17x NTM EV/EBITDA. The "luxury premium" was paid despite Tiffany & Co having low growth, stiff competition, and, most importantly, a brand that has become out of favor with millennials.

RH is the only luxury platform with no competition, a tremendous moat, a brand that is loved by millennials, and a business that has yet to go international, and most importantly the most desirable buildings in almost every major U.S. city. If tomorrow we applied the Tiffany & Co takeout multiple to RH, the stock would trade at $350.

RH 2020 EBITDA	$567	$567	$567
EV/EBITDA Multiple	17x	20x	26x
Enterprise Value	$9,639	$11,340	$14,742
Debt	$984	$984	$984
Minority Interest	$0	$0	$0
Cash	$38	$38	$38
Market Cap	$8,693	$10,394	$13,796
Shares Outstanding	25	25	25
RH Price Target	**$348**	**$416**	**$552**

Citron believes this quality asset will be pursued by either:

- Berkshire Hathaway
- Amazon
- LVMH
- Private Equity (namely L Catterton – the largest consumer-dedicated PE firm in the world)

Citron has offset our RH long with our Wayfair short – Yes, we still believe Wayfair's growth without profitability or differentiation has finally caught up to this perpetually money losing operation. The Wayfair short has lasted way too long, but we are more comfortable now than ever.

Peloton Short – Price Target of $5

During the writing of this letter I saw for the first time a commercial on CNBC for Peloton advertising the Peloton App for $12.99 a month and as the commercial emphasized "**with any equipment or no equipment at all.**" Citron put a one-year price target of $5 and we stand by it as $5 makes this still a $1.5 billion company.

Citron is very comfortable with our position as we know CEO Foley is trying to prop the stock up ahead of its lock-up expiry in March as he most famously stated:

"You've got to rob a few gas stations on the way to the perfect crime."

Instead of giving a full report in this letter, readers can choose any of these reasons as to why Peloton will end the year at $5:

- It competes against itself in pricing – a $12.99 monthly fee for digital app without equipment vs. $39.00 with Peloton equipment
- Competition is undercutting them on every product
- We know who bought the first 500k bikes at $2,245 – who buys the next 500k?
- Music rights make the "spin experience" difficult to scale
- Management cannot be trusted
- Implausible churn figure will catch up to management

CEO Foley should have nothing to be ashamed of as at $5 he will still have the most valuable exercise equipment company in the world.

Conclusion

The team at Citron will continue to work on our processes in 2020 and react to opportunities that continue to be present in a market filled with short-term inefficiencies. 2020 will be a year of growth as we look to expand our team beyond Los Angeles and bring on new analysts from New York and Western Europe. In what will be our 19th year publishing Citron Research we continue to wish everyone "Cautious Investing."

Living your life as a short seller is the feeling best stated by Yogi Berra:
"It ain't the heat, it's the humility."

Sincerely,

Andrew Left

Managing Partner of Citron Capital LLC

Notes and Disclosures

Citron Capital is an exempt reporting investment adviser registered with the California Department of Business Oversight. Citron Capital manages a pooled investment vehicle, Citron Capital, LP ("Fund"). Fund returns presented are unaudited, net of all fees and expenses, including accrued but unpaid performance fees. The first audit report for the Fund will follow the 2019 calendar year.

Further disclosures regarding the risks associated with the firm's investment approach are contained in the Fund's offering memorandum and the firm's Form ADV. Additional information is available upon request. Past performance may not be predictive of future results.

This letter is for informational purposes only and does not constitute an offer of securities or an offer to provide investment advisory services. It should not be construed as an offer to sell or the solicitation of an offer to purchase interests in the Fund in any jurisdiction. Such offer can be made only by means of the offering documents of the Fund. Interests in the Fund are offered within the United States exclusively to accredited investors under Rule 506(b).