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Q2 2018 INVESTOR LETTER

CONFIDENTIAL – NOT FOR DISTRIBUTION

July 25, 2018

Dear Investor,

Q2 is in the books and we're pleased to report a strong quarter. Our deep, fundamental research paid off nicely for our investors as the portfolio fired on all cylinders with both the long and short books posting impressive clips. With new developments in some of our larger holdings and two new fresh ideas added in the quarter, we find ourselves very excited about the portfolio heading into the second half of the year.

The week of July 16th marked the 10th and final week with our summer intern, who we are sad to see go. We are very appreciative of the opportunity to work with a talented young investor and we enjoyed working together analyzing the Cybersecurity industry.

Q2'18 Highlights

- Net Performance - The fund returned 4.92% net of fees compared to 2.93% for the S&P500 and 1.18% for the Barclay Hedge Fund Index, an outperformance of 1.99% and 3.74% respectively. Year to date, the fund has returned 12.33% compared to 1.68% for the S&P500 and 0.98% for the Barclay Hedge Fund Index, an outperformance of 10.66% and 11.35% respectively.
- Short Performance – The short book returned 0.50% in the quarter compared to (-3.20%) for the Proshares Short S&P 500 Index, an outperformance of 3.70%. Year to date, the short book has returned 4.63% compared to (-1.20%) for the Proshares Short S&P 500 Index, an outperformance of 5.83%.
- Long Performance – The long book returned 5.96% in the quarter compared to 2.93% for the S&P 500, an outperformance of 3.03%. Year to date, the long book has returned 11.81% compared to 1.67% for the S&P 500, an outperformance of 10.14%.

		2018													
NET PERFORMANCE	2017	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Since Inception
Fund	22.02%	6.76%	(0.17%)	0.46%	1.32%	3.14%	0.40%							12.33%	37.11%
S&P 500	19.42%	5.62%	(3.89%)	(2.69%)	0.27%	2.16%	0.48%							1.67%	21.42%
BHFI	10.52%	2.07%	(1.52%)	(0.72%)	0.45%	0.75%	(0.02%)							0.98%	11.49%
Fund v S&P 500	2.60%	1.14%	3.72%	3.15%	1.05%	0.98%	(0.08%)							10.66%	15.69%
Fund v BHFI	11.50%	4.69%	1.35%	1.18%	0.87%	2.39%	0.42%							11.35%	25.62%

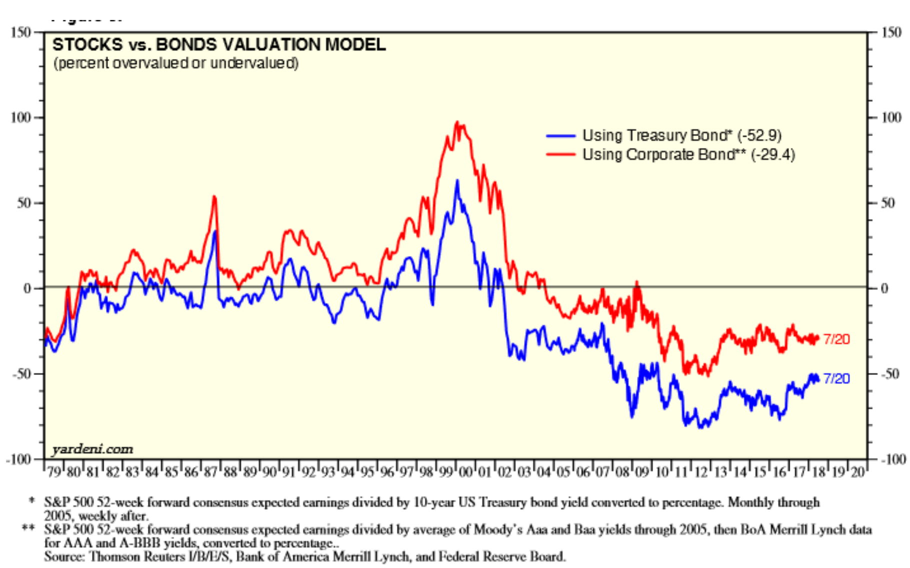
Current Investing Environment

As we approach the end of July, the S&P 500 is up 5% year to date. GDP continues to churn along at a healthy 2%+ rate, inflation has ticked up although remains well within the Fed's target, and unemployment now sits below the 4% mark. Interest rates have increased, and the yield curve has flattened. The fundamentals support 3-4 more years of economic expansion, although geopolitical tensions have become the constant elephant in the room and are the biggest threat to derail the economy as it has become increasingly difficult to differentiate between what's real and what's posturing. Overall, we remain positive on stocks although we believe it is increasingly important to invest carefully.

Within equities, we believe stocks remain undervalued, particularly high growth stocks. Factoring in a 10% contraction year to date in the S&P 500 Price to Earnings multiple, headline S&P 500 valuation numbers still sit at the high end of historical averages. We believe this is misleading and does not tell the whole story.

(1) Equities are undervalued when factoring in interest rates. As I write about in the [2017 Annual Investor Letter], interest rate levels should be factored in when making comparisons across different stock market regimes. We prefer the Fed Model, presented below, which indicates equities are undervalued by as much as 24% after factoring in a 5% Equity Risk Premium.

Exhibit: Fed Model Comparing Equities with Corporate Bonds and Treasury Bonds

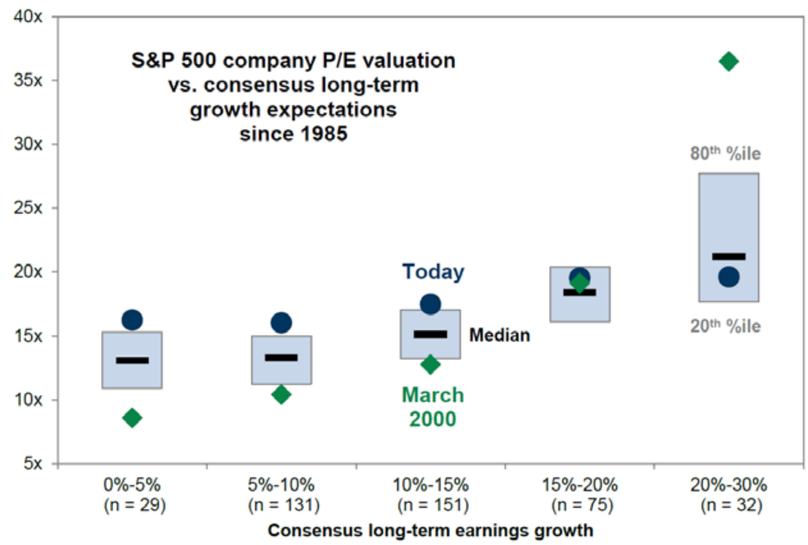


Source: Yardeni

(2) *Value stocks appear expensive historically while high growth stocks appear inexpensive.* The exhibit on the next page is a bit confusing but provides some valuable insight so bear with me. Equities are organized into 5 buckets, based on expectations for long-term earnings growth, beginning with the 0% to 5% bucket on the far left ranging up to the 20% to 30% long-term earnings growth bucket on the far right. The vertical axis is price to earnings. The three markers to understand are the black dash, which represents the median price to earnings for each bucket, the blue circle, which represents the current level of price to earnings and the light blue rectangle, of which the bottom and top represent the historical 20th and 80th percentile.

The exhibit indicates that all but the highest growth bucket is trading above median price to earnings levels in varying levels of magnitude, indicating they are expensive compared to historical value, while the highest growth bucket is trading below the median price to earnings level, indicating a bargain in historical context. To say more concisely, growth stocks with strong earnings growth appear cheap while value stocks and other low growth equities appear expensive before factoring in interest rates.

Exhibit: Current Valuation Within Historical Context of Equities Bucketed by Long Term Earnings Growth



Source: Goldman Sachs

Investing Implications – Where to Invest Now

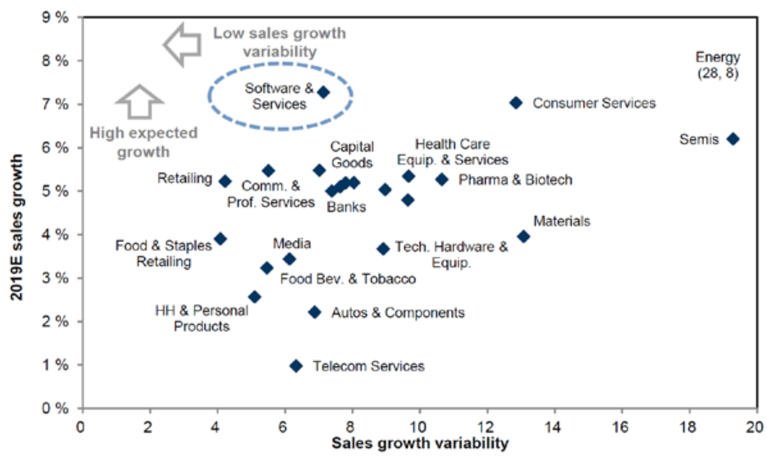
Later in the cycle with geopolitical risks rising wage inflation increasing and growth underpriced, we prefer non-cyclical growth that is highly recurring. Balance Sheet quality increases in importance and we prefer to avoid companies with floating rate debt and high exposure to labor costs. We believe (1) Software and Services and (2) Financials are great places to invest.

(1) **Software and Services** – Emotionally, people think of all tech investing as boom and bust and we believe strongly this view is outdated. Corporate software has become intricately interwoven with core business processes across Corporate America. While previously corporations could delay purchasing updated versions of software in times of financial stress, shifts to subscription models have removed this potential sales volatility and made Software and Services one of the stickiest, least cyclical businesses in our view. Factoring in growth potential, we believe the industry is where investors should have their largest allocation. We acknowledge this view is contrary to consensus, but the consensus view is outdated in our view and an example of investors' tendency to fight the previous war.

We prefer GARP names such as **Microsoft** (owned), **Citrix** (owned)**, Intuit** (not owned)**,** and **Adobe** (not owned) to name a few and shy away from high flying **SaaS** stocks due to high valuations that make the stocks vulnerable during market stresses. Supporting exhibits are presented on the following page.

- Software and Services offers the most attractive combination of sales growth and low growth variability, indicating upside from revenue growth with limited downside due to low sales growth variability, a proxy for revenue stickiness.

<u>Exhibit: Comparing Sales Growth with Sales Growth Variability by Industry</u>

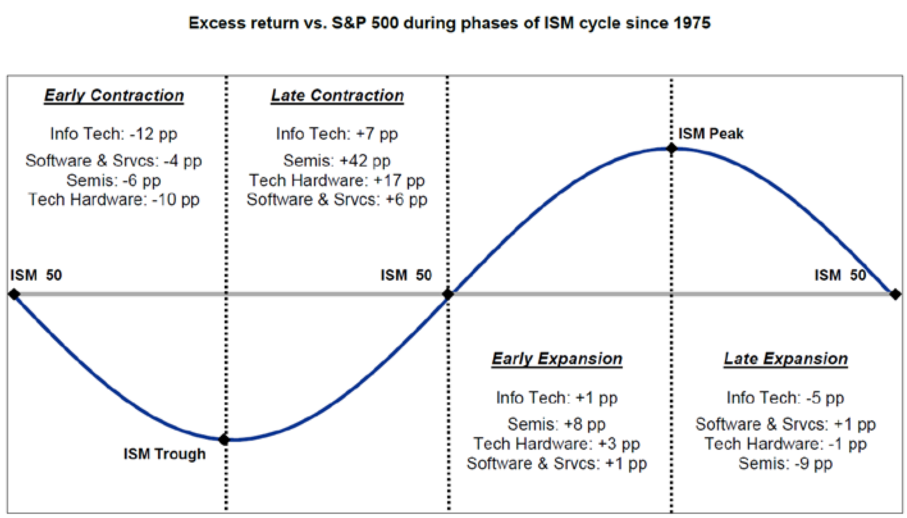


Sales growth variability: defined as the median company's standard deviation of trailing quarterly year over year sales growth during the past 5 years

Source: Goldman Sachs

- Software and Services historically outperforms late into the cycle while Semiconductors and Hardware are more of the boom and bust investors tend to associate with Tech investing.

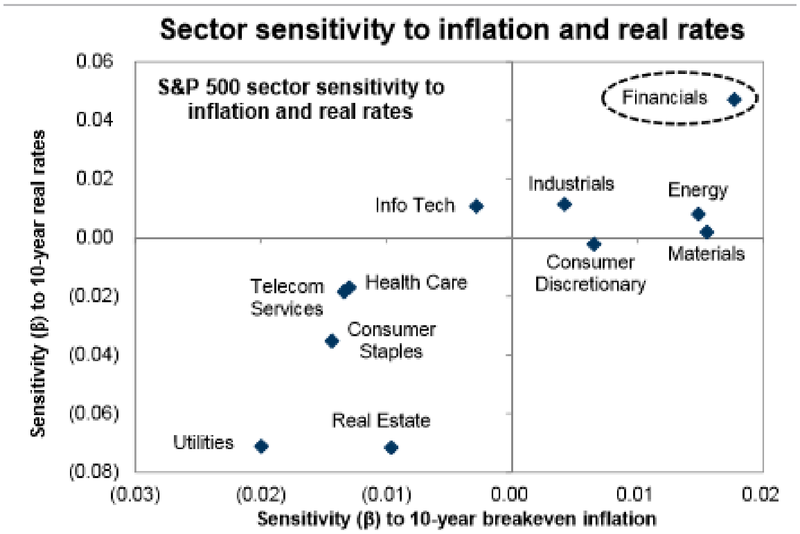
<u>Exhibit: Technology Investing through the Economic Cycle</u>



Source: Goldman Sachs

(2) **Financials** benefit from rising interest rates while Consumer Staples, Utilities and Real Estate lag. While we may tilt exposures on the margin, the dependence of Financials on macroeconomic factors and the scarcity of secular growth within the sector cause us to limit our exposure.

Exhibit: Sensitivity by Sector to Real Interest Rates and Inflation



Source: Goldman Sachs

Contributors and Detractors – Q2'18

Q2'18 Contributors Detractors				
Contributors			**Detractors**	
Facebook	2.0%		Match Group	(0.7%)
Electronic Arts	1.4%		Xylem	(0.5%)
Netflix	1.0%		Sodastream	(0.4%)
United Healthcare	0.8%		Constellation Brands	(0.3%)
Citrix	0.7%		Total	(1.9%)
Microsoft	0.6%			
Visa	0.6%			
Teleperformance	0.6%			
Total	7.8%			
*Represents contributors >50 basis points and detractors <30 basis points				

Please see the corresponding Q2'18 Exposure/Attribution report for further detail on performance attribution.

Notable Purchases and Sales – Q2'18

On the long side, we initiated a new position in **TD Ameritrade (AMTD)** due to the defensive nature of its core business, the tailwind from increasing interest rates, $500M in synergies from the Scottrade integration, and an attractive valuation. We rolled our position in **PayPal (PYPL)** into **Visa (V)** as the stocks present similar growth opportunities in our view and V trades at a 20% discount with a stronger competitive position. We added a new position in **TripAdvisor (TRIP)** and added to our position in **Electronic Arts (EA)**, both of which we detail at length below. We trimmed our position in **Sherwin Williams (SHW)** due to incremental concerns in their Performance Coating business, although we maintain a constructive view on the stock.

On the short side, we leaned into two of our **Software and Services** shorts, a large IT Services company and a social media company, and pressed our **Food Products** shorts to bring in line with target weights. We added to our **Industrial Conglomerate** short and we initiated a new **Semiconductor** position.

Lastly, we covered our position in **Symantec (SYMC)** as noted in May 2018 Monthly Investor Letter.

Investment Commentary

As you know by now, we believe that wealth is created when exceptional businesses compound earnings over many years. Conversely, we believe wealth is created on the short side when inferior businesses with limited strategic options negatively compound earnings over multiple years.

Before we initiate a position, we develop a testable investment thesis that guides our investment decisions throughout the life of the investment. We continually monitor and incorporate new information into our investment views. We typically sell or cover our positions when the thesis breaks or we believe another idea offers better returns.

On the long side we look for 3 types of companies:

(1) Compounders - Companies with attractive business models, innovative management teams, and financial flexibility that we believe can compound at above market growth rates for a full economic cycle
(2) Mix Shifts - Companies with high earnings visibility shifting from a legacy business to a higher margin, more attractive business
(3) Turnarounds - Underperforming companies that change management or experience another catalyst that changes the future prospects of the business

On the short side we look for 3 types of companies:

(1) Disrupted - Companies with deteriorating competitive positioning due to changing consumer preferences, disruptive competition, cost disadvantages, or inferior products
(2) Share Donors - Companies with flawed business models or mismanaged assets that we believe will cede significant share over time
(3) Mismanaged/Accounting - Companies with poor internal controls and poor corporate governance that use aggressive bordering on fraudulent accounting practices, masking the true economics of the business

Electronic Arts (EA)

Last month, the company presented at the E3 Expo, the major video game industry conference, in which the company provided an update on a few big initiatives that are atop of investors' mind. Our takeaways, which we present below along with the announcements, are that the prospects for EA and the video game industry are as promising as they have been since I began covering the stock, which is saying something in the context of the industry growth the last 5 years.

(1) Cloud Gaming aka Gaming as a Service (GaaS) – At the event, EA demoed their progress on video game streaming. Our takeaway is that viability is much further along than we previously believed and provides a glimpse into the future of gaming. *What is cloud gaming?*

> *"Traditional Gaming involves using your own Hardware to power your Gaming Experience. Your Computer or Game Console is actually rendering Graphics and making everything happen. The Computer or Game Console has to be attached to a non-mobile screen in order to be useful. Cloud Gaming is different. Instead of using your device to power your Gaming Experience, Cloud Gaming is powered by a server over the internet. The server does all of the heavy lifting, and your device is merely streaming audio and video. It's almost like watching a movie on Netflix, but you're playing a Video Game. This creates an advantage compared to Traditional Gaming. "* [1]

Streaming is important because it removes the need to purchase a console, a ~$500 barrier for all but the avid gamers and expands the Total Addressable Market from roughly 130 million gamers, the current number of avid PC/console gamers, to 700 million people, or the total number of people who play mobile games.

The development is significant for 3 reasons. First, from a cost perspective, streaming will decrease EA's development costs as customization required to tailor each game to each platform (Xbox, PlayStation, Mobile, etc.) will greatly decrease. Customization will still exist for each platform, but the focus will be on increased monetization opportunities rather than purely extra developmental costs. Second, streaming will drive platform convergence, similar to what Microsoft has done with Microsoft Word, ensuring the same gaming experience across all devices. The convergence will lead to increased engagement and an overall better experience for gamers. Third, streaming and platform convergence will allow EA to greatly reduce the current friction limiting the conversion of mobiles gamers to the more profitable full-game experience – the experience currently available on console. If gamers can easily transition their mobile game Sims or Madden sessions to their living room TV with a device similar to a Chromecast or Fire Stick, "avid gamers", engagement, and monetization will all increase.

All in all, streaming is an unequivocal positive for the industry and further along than Blue Hawk and consensus previously believed. We do not include the effects of streaming currently in our model and we view it as an upside to our current estimates.

(2) Subscription Expansion – the company announced the expansion of their existing EA Origin subscription program to title Origin Access Premier, a PC subscription service that features titles in addition to the non-premium titles (older games) offered on the existing service. In addition, the new service allows for early access to the newest releases before official launch date.

[1] http://flickstiq.com/what-is-cloud-gaming/

This move is important because it's perceived as a test trial by the company for a full-on subscription service, which we know from software is a far superior business with superior economics. With subscription, both customer acquisition costs and year to year churn decrease significantly and the hit driven nature of video games, the bear thesis on the industry that has partially subsided but still exists as an overhang, is all but eliminated.

In addition, this move is the first in which EA is openly encouraging gamers to bypass retail and buy online. Historically, EA has been reliant on vendors such as **GameStop** to sell their games and thus they have been careful to manage the relationship, but with a current game sale mix of 70%/30% online to retail from a 50%/50% split a few years ago, the implication is that EA no longer feels this need. This is significant because the economics of online downloads are significantly better for EA than retail sales. To illustrate the magnitude of the difference in profitability, a 100%/0% online console mix would add roughly $6B in economic value to the stock per Blue Hawk estimates. And this estimate does not factor in the benefit from a reduction in marketing costs that occurs in a subscription model – a subscription model requires a periodic software update instead of the production of a new game each year with heavy promotional spend to sell units. The shift to Office 365 for Microsoft is an appropriate comparison.

(3) Modeling of Live Services by Wall Street – This point is more technical but is nonetheless a material source of short to medium term upside for the stock. There are different models to evaluate changes stock prices, one of which is results relative to investor expectations, or an **Investor Expectations Model**. *Read directly below if you are unfamiliar with such a model.*

In an **Investor Expectations Model**, stock prices are driven by changes in investor expectations and a major source of changing expectations are earnings surprises and disappointments. Better or worse than expected earnings cause investors to revise expectations. At Blue Hawk, we use an expectations model to determine if a stock we like over the long term has potential near term risk or potential near-term catalysts, which we place within the context of a more robust analysis. To say another way, earnings expectations matter for a stock in the near term.

We believe The Street is materially underestimating EA's earnings power over the next 4 quarters. The first reason relates to how The Street models Live Services (Extra Content), which does not accurately reflect the drivers of the business. The Street oversimplifies and simply applies a growth rate to last year's revenue. For example, revenue in EA's Live Services was $2,189 last year and a 10-15% growth year over year and would yield $2,400 to $2,500 in Live Services Revenue. The correct method to model the segment is to multiply an attach rate to an installation base - also known as the **razor blade model**. Gillette's razor blade sales, like EA's Live Services, are dependent on the number of razors sold the last few years as EA's extra content is dependent on the number of video game units sold. You are not going to buy a razor blade if you do not own a Gillette razor. The correct way to model this is with an installed base, or the total number of razors you estimate are currently in circulation and use, and an attach rate, or the number of razors purchased per year per razor in circulation.

The issue is exacerbated due to a one-time jump in unit sales. EA's video game unit sales, presented to the right, are relatively steady

	FY15	FY16	FY17	FY18
EA Unit Sales	56.4	57.2	59.6	52.8
y/y growth		1.4%	4.3%	(11.5%)

except for last year, in which, as you may recall, an issue with their flagship title Battlefield caused unit sales to dip by 11.5%. As unit sales revert to normalized levels, as Blue Hawk and The Street both model, unit sales will grow greater than normal, estimated around 10-12%. In addition, the attach rate should continue to improve, we believe at a 20%+ better rate than last year. As the attach rate is multiplied by the installed base, an underestimated install base is compounded, increasing the differences in estimates. Crunching the numbers, the oversimplification causes The Street to meaningfully underestimate Live Services growth in Fiscal Year 2019 in the range of 10-20%.

(4) Conclusion – We have a 1-year Price Target of $170 and a 2-year Price Target of $206, implying the stock remains 14% and 39% undervalued over the respective time horizons, and we are incrementally more positive on the long-term prospects of the industry after the E3 Expo.

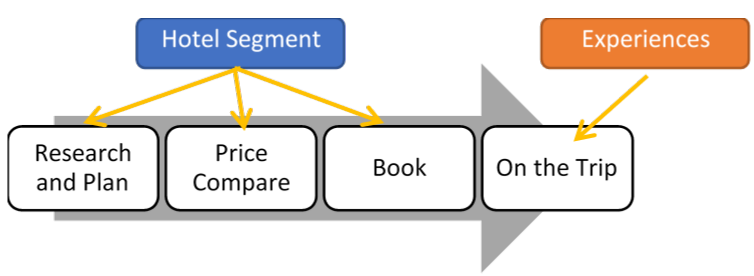
TripAdvisor (TRIP)

TRIP is the leading online travel platform. The company's user generated content in the form reviews, opinions, advice, and photographs make it the leading destination for travelers researching and planning trips. On the supply side of the platform, Online Travel Agencies (OTA) and direct suppliers (hotels, airlines, etc.) list inventory in the form of hotels, accommodations, restaurants, flights, and cruises with the goal of converting users' travel demand into bookings. TRIP monetizes through display-based advertising and transaction-based advertising (i.e. commission on a hotel room booking). The company is organized into 2 segments, Hotel and Non-Hotel (Experiences).

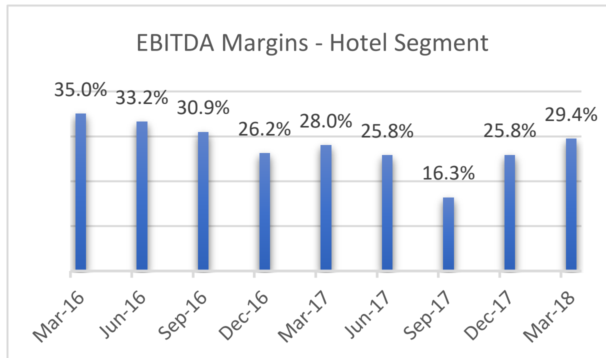
Our thesis is that TRIP is a high-quality asset with a strong competitive moat and will return to compounding EBITDA in the high teens/low twenties in 2019. Our conviction comes from two areas: (1) Margins in the Hotel Segment have stabilized as the strength of the TripAdvisor brand has allowed the company to strategically pivot and improve their strategic position within the industry (2) Innovation in the Experiences segment has created a rapidly growing, complimentary business with minimal incremental costs that we believe is worth $5B+. All in all, we believe TRIP will return to 20% EBITDA growth in 2019 and we think the stock is 40%+ undervalued.

From a high level, TripAdvisor is a travel platform built for users researching and planning a trip. The typical steps in planning and booking a trip, the "Travel Journey", are provided below. Typically, the first and biggest transactions are travel (airfare) and accommodations, which are typically booked before the beginning of the trip.

<u>Exhibit: "The Travel Journey"</u>



(1) Core Business - I have been following TripAdvisor for about 5 years now and up until recently the same overhang has kept me on the sidelines. TripAdvisor's user generated content, the holy grail in ecommerce as its highly trusted by users and impossible to self-generate by a company, has given the platform a strong competitive moat and differentiation. The competitiveness of the **Online Travel Agency (OTA)** industry however, coupled with the industry/company's reliance on **Google** for customer acquisition, has resulted in a spending war for the acquisition of incremental traffic, one in which Google has profited at the expense of the industry. At 1/10th the size of **Priceline** and 2/5th the size of **Expedia**, TRIP's spending resulted in the eroding of margins.



With declining margins and competition increasing, TRIP pivoted about a year ago. Specifically, they shifted their marketing spend earlier in the "Travel Journey" into the less competitive "Research and Plan" leg from the heavily contested "Price Compare" leg. *Price Compares* are looking for the cheapest rate and are sought after by Priceline and other OTA heavyweights while *Research and Planners* are looking for information to plan a trip in organized manner. TRIP's new strategy is the same strategy that **Amazon** uses – investing in brand awareness instead of bidding on Google for customer acquisition – and is why Amazon no longer needs to have the lowest prices. Users arrive at the platform direct instead of through Google – making the users stickier and reducing competition.

The result is TripAdvisor acquires a less cost-conscious customer and thus a higher quality lead, which has shown up in the numbers. Margins in the Hotel segment have improved without impacting traffic growth, an indication of a healthy platform ecosystem. We estimate Hotel EBITDA margins will settle in the high 20s over the next 2 to 3 years.

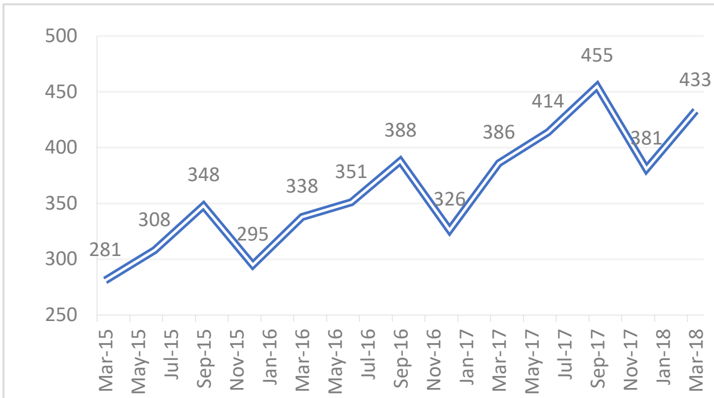
(2) Experiences - In 2015, TRIP began expanding aggressively into Experiences (tours, museums, etc.), smaller dollar transactions that are booked later in the process and often while on the trip. Experiences often require additional research compared to travel/accommodations, as they are generally offered by small businesses in foreign regions and are one of the few products in which advertising improves the experience – a typical trip can include many different experiences from separate vendors and booking within the TripAdvisor platform is preferable to searching for the websites of 5-10 outside vendors. TRIP's unique platform and content provide unique positioning to pursue this rapidly growing and attractive new business.

Much of the current and future growth in the Attractions business will come from converting attractions to bookable attractions, which should be low hanging fruit. Currently, only 104,000 of the 790,000 attractions are bookable on the TRIP platform or 13% penetration, leaving 87% runway based on simple execution. And lastly, the economics to investors are attractive as the new business requires minimal additional investment – operational and marketing spend – so the segment should add incremental revenue with limited incremental costs, great news for investors.

In all, we think the Experiences business will be worth $5B in 2 years.

(3) Overall - TRIP's repositioning removes the overhang previously keeping us on the sidelines, and combined with the unique platform, differentiated content, secular tailwinds, incremental growth opportunities, and attractive entry point, we have initiated a position of TRIP into the portfolio. Our 1-year Price Target is $84.

Exhibit: TripAdvisor Unique Monthly Average Users (Mil)



To conclude, we thank our investors for their support. Please reach out with any questions.

Sincerely,

Jake DuBois, Managing Member

Appendix

Terms

FOUNDERS CLASS*	
Minimum	$5 million
Management Fee	1% AUM monthly*
Performance Fee	15% yearly*
High Water Mark	Yes
Lockup	3 year hard lock up
Redemptions	30 day notice
Gate	None
Eligibility	Until AUM reaches $25 million

CLASS A	
Minimum	$250,000
Management Fee	1.5% AUM monthly*
Performance Fee	15% yearly
High Water Mark	Yes
Lockup	1 year soft lockup
Redemptions	30 day notice
Gate	None

Definitions

Alpha is a measure of the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta

Beta is a measure of a fund's sensitivity to market movements.

Net asset value (NAV) - a fund's net asset value (NAV) represents its per-share price. A fund's NAV is derived by dividing the total net assets of the fund, less fees and expenses, by the number of shares outstanding

Sharpe Ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. The ratio helps to make the performance of one portfolio comparable to that of another portfolio by making an adjustment for risk.

Source: Morningstar

Disclosures

Performance Calculations:

Valuations and returns are stated in US Dollars. The calculation of gross-of-fees returns reflects the aggregate performance of all investors minus trading commissions. The calculation of net-of-fees returns reflects the aggregate performance of all un-affiliated investors. This specific share class is subject to the deduction of a 1% management fee and 15% incentive fee with a high-water mark. Net returns are also net of operating expenses, which includes an administration fee, audit fee, and other miscellaneous operating expenses. We believe this return best reflects the performance a typical investor would have achieved. Please refer to the Private Placement Memorandum for a full list of operating expenses.

Past performance does not guarantee future results. **Please see the Private Placement Memorandum for a full list of disclosures.**