October 23, 2012

Dear Partner:

The Greenlight Capital funds (the "Partnerships") returned 9.4%[1], net of fees and expenses, in the third quarter of 2012, bringing the year to date net return to 13.2%.

The market faced some significant obstacles in the third quarter. European and Asian economies slowed considerably, the U.S. economy slowed moderately, and oil prices rose modestly. Corn, wheat, and soybean prices soared, as the U.S. began to feel the shocks of its worst drought in decades. Corporate earnings growth disappeared, as many companies missed revenue and earnings estimates and lowered guidance. Nonetheless, global monetary policy enabled the market to overcome these headwinds, and the S&P 500 rallied to a 6.4% return in the quarter.

Central bankers have been on a money printing spree. In Japan, they expanded monetary easing by ¥10 trillion. In the U.K., the Bank of England monetized another £50 billion of gilts. ECB President Mario Draghi promised "unlimited" bond buying, and the Swiss are committed to putting a floor under the Franc through unlimited purchases of Euros and other assets.

This buying binge brings to mind American Express cards, which are famous for their promise of no pre-set spending limits. But as some AmEx customers have learned, there *is* a spending limit – they just don't tell you what it is. AmEx anticipates how much you can repay based on your annual income and your payment history. When your charges exceed their estimates, they cut you off until you pay off your balance.

Central bankers should keep this dynamic in mind, as they continue to run their printing presses. While the ink may be endless, the market's tolerance is not (though there is no sign that it is nearly exhausted). Like American Express, the market won't let the central bankers know what their spending limits are until they have exceeded them and get cut off.

Here in the U.S., Chairman Bernanke announced desperate measures in non-desperate times. The Fed will be using its new AmEx Debasium card to buy a minimum of $40 billion per month worth of mortgage-backed securities…*indefinitely*. If the job market doesn't show "substantial improvement" the Fed might increase its monthly MBS allocation, or head over to aisle 3 to pick up some Treasuries. When asked what would bring the binge to an end, Chairman Bernanke was more intent on emphasizing all the things that would necessitate

[1] Source: Greenlight Capital. Please refer to information contained in the disclosures at the end of the letter.

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

further easing. In conjunction with the money printing, Chairman Bernanke has promised zero percent interest rates through the middle of 2015.

It seems as if nothing will stop the money printing, and Chairman Bernanke in fact assures us that it will continue even *after* the economic recovery strengthens. Specifically, he says, "Even after the economy starts to recover more quickly, even after the unemployment rate begins to move down more decisively, we're not going to rush to begin to tighten policy." Apparently, anything less than a $40 billion per month subscription order for MBS is now considered 'tightening'. He's letting us know that what once looked like a purchasing spree of unimaginable proportions is now just the monthly budget.

Chairman Bernanke concedes that this policy hurts savers, then offers some verbal sleight-of-hand worthy of a three-card monte hustle: He says the savers are helped by low rates because low rates support higher asset values and promote a healthy and growing economy. He then goes on to say that because savers benefit from a healthy and growing economy, we must therefore have an accommodative policy. This in turn begs the question: Does an accommodative policy promote a healthy economy? Chairman Bernanke argues that higher asset values create a wealth effect, which he again describes, "if people feel that their financial situation is better because their 401(k) looks better or for whatever reason, their house is worth more, they are more willing to go out and spend."

We have just spent 15 years learning that a policy of creating asset bubbles is a bad idea, so it is hard to imagine why the Fed wants to create another one. But perhaps the more basic question is: How fruitful is the wealth effect? Is the additional spending that these volatile paper profits are intended to induce overwhelmed by the lost consumption of the many savers who are deprived of steady, recurring interest income? We have asked several well-known economists who publicly support the Fed's policy and found that they don't have good answers.

If Chairman Bernanke is setting distant and hard-to-achieve benchmarks for when he would reverse course, it is possibly because he understands that it may never come to that. Sooner or later, we will enter another recession. It could come from normal cyclicality, or it could come from an exogenous shock. Either way, when it comes, it is very likely we will enter it prior to the Fed having 'normalized' monetary policy, and we'll have a large fiscal deficit to boot. What tools will the Fed and the Congress have at that point? If the Fed is willing to deploy this new set of desperate measures in these frustrating, but non-desperate times, what will it do then? We don't know, but a large allocation to gold still seems like a very good idea.

Speaking of gold, it joined Apple (AAPL), Arkema (France: AKE), Seagate (STX), Sprint (S) and one undisclosed short in making a material contribution to the quarterly return. An undisclosed macro position was the only loser of consequence. Overall, the longs contributed all the quarterly gains, while the short portfolio lost less than 1%.

At the recent Value Investing Congress, David updated our view of Green Mountain Coffee Roasters (GMCR), elaborated on our General Motors (GM) and Cigna (CI) theses, and disclosed our short position in Chipotle Mexican Grill (CMG).

Regarding GMCR, we pointed out:

- It is implausible that the GMCR audit committee conducted a serious investigation of our allegations in a mere 23 days after last year's Value Investing Congress;
- GMCR management has trivialized the competitive threat posed by Starbucks' new Verismo coffee and espresso maker, and we see a risk that Starbucks will renegotiate or even walk away from its partnership with GMCR;
- GMCR's key patents for K-Cups have expired leaving the company in a vulnerable position because:
    - It is the high cost producer in what will become a highly competitive commodity manufacturing business;
    - GMCR does not control any important brands (its license deals with Starbucks, Dunkin' Donuts and Smuckers are subject to renegotiation);
    - There are nine competitors who are either already producing or about to launch competitive K-Cups and will have substantial capacity by the end of next year;
    - GMCR recently lowered the list price of many of its leading products by about 8 cents per K-Cup. This will likely have a large impact, as last quarter GMCR only made 8 cents per K-Cup.

In expanding on our GM thesis, we argued that the company has not been given credit for its improved competitive and financial position post-bankruptcy. At $24.75 per share, GM trades at 8x this year's earnings of about $3 per share. GM is poised to benefit from continued recovery in the U.S. market, a significant product upgrade cycle, eventual restructuring in Europe, and continued growth in China and Brazil. We view the government stake as an opportunity, rather than an overhang. Post-election, we expect the government to sell its shares, and GM has the funds to be the buyer in what would be a highly accretive transaction. Should the government decide to keep its stake, GM could achieve the same benefit through open market buybacks. Assuming the buyback, all told, GM has the ability to earn $8 of (untaxed) cash earnings per share in 2014 in a mid-cycle environment.

Regarding CI, we discussed that it trades at a discount to the HMOs, which as a group trade at low multiples. We then illustrated that CI is a higher-quality business that generates superior and more stable returns on equity than its peer group. With a substantial emphasis on Administrative Services Only business, CI deserves a higher multiple closer to the business process outsourcing companies (such as ADP) than to the HMOs. CI also has a significant and growing Medicare Advantage business and a fast growing international business. Finally, we noted that since the vast majority of its customers are large and mid-sized enterprises, CI has much less exposure to the known risks of Obamacare including health care exchanges. In fact, Obamacare may provide a growth opportunity for the company because it may finally afford CI the opportunity to compete meaningfully in the individual segment of the market.

In presenting our short thesis on CMG, we noted that the stock trades at a premium multiple but faces significant headwinds including rising food costs, higher healthcare costs related to Obamacare, and competition from a resurgent Taco Bell. We conducted a consumer survey that provided evidence that Taco Bell's new Cantina Bell menu, priced at a substantial discount to CMG's average menu item, will draw customers away from CMG.

The protests from CMG's bullish supporters can be summarized as:

- ¡No Quiero Taco Bell!
- Have you ever actually tried the food!?!
- Have you seen the lines at CMG?

CMG and its bullish supporters insist that CMG has a completely different customer base than Taco Bell. However, our survey results show otherwise. We believe Taco Bell will pluck away some percentage of CMG's customers, which will cause CMG's same store sales to deteriorate. Given CMG's high valuation, we don't believe the market will be forgiving.

We surveyed 1,608 CMG customers. Of those, 25% never go to Taco Bell, and their median income (about $59,300) skews higher than the average CMG customer. Of the remaining 75%, almost one-third of them had ordered from the Cantina Bell menu within the first 50 days of launch. The preliminary results aren't favorable for CMG: Half preferred CMG, but the other half either preferred Cantina Bell or rated them equally. The latter group tends to be younger (median age: 26) and less well-to-do (median income: $36,600).

More importantly, we found that CMG's highest frequency customer—those who go a couple times a week or more—are much more likely to have tried Cantina Bell, more likely to prefer Cantina Bell to CMG, more likely to return to Taco Bell more often as a result of the Cantina Bell menu introduction, and twice as likely to cut down on trips to CMG as compared to the average CMG customer.

Our survey found that more than a third of CMG's customers are 18-24 years old (we didn't survey people younger than 18) and more than two-fifths of CMG's customers earn less than $40,000 per year. On the margin, this group is likely to show up at CMG a bit less often.

The Partnerships closed out their CareFusion (CFN) position during the quarter. The company failed to achieve the earnings we hoped it could generate. Even so, the investment compounded at a double-digit rate over our three years of ownership. We wish all our "unsuccessful" investments did so well.

We had one new hire and two organic additions to the team in the quarter. We hired Andrew Frohman as a research associate in Dallas. Andrew graduated *summa cum laude* from Stephen F. Austin State University and has an M.B.A. from Texas A&M. He worked for PricewaterhouseCoopers where he provided advisory services to clients in a variety of areas. Andrew is a CPA and has successfully completed all three levels of the CFA exam. In addition, Andrew was a high school first team, all-district basketball player on a team that almost went to the state championship. While Andrew's strong analytical background is quite obvious, the operations staff cannot help but be a little suspicious as to the timing of his hire relative to the annual Operations vs. Investment team basketball game. Welcome Andrew!

The two new additions to the Greenlight team this quarter are Charles Edward Lin, the third son born to James and his wife Tina, and Nathaniel James Ennis Weisstub, the first child of Jeremy and his wife Jessica. Congrats to the Lin and Weisstub families!

Please mark your calendar for our Seventeenth Annual Partners' Dinner, scheduled for Tuesday, January 22, 2013. The meeting will be held at the American Museum of Natural History in New York. We've become quite fond of the Great Green Whale. We will be sending out formal invitations shortly.

At quarter end, the largest disclosed long positions in the Partnerships were Apple, Cigna, General Motors, gold and Seagate Technology. The Partnerships had an average exposure of 97% long and 69% short.

"Why would the bursting of the bubble be called a tail risk, rather than the logical outcome?"

-- Martin Sibileau

Best Regards,

Greenlight Capital

Greenlight Capital, Inc.

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Performance returns reflect the dollar-weighted average total returns, net of fees and expenses, for an IPO eligible partner for Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., Greenlight Capital Offshore, and the dollar series returns of Greenlight Capital (Gold), L.P. and Greenlight Capital Offshore (Gold), Ltd. (collectively, the "Partnerships"). Each Partnership's performance returns are calculated using the returns for partners who were invested on or prior to January 1, 2008, except for the returns of Greenlight Capital (Gold), L.P. and Greenlight Capital Offshore (Gold), Ltd, which reflect the dollar series returns for partners who transferred into these funds at inception and who were invested in a predecessor Greenlight fund on or prior to January 1, 2008. Each Partnership's returns are net of the standard 20% incentive allocation (except the annual returns for Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., and Greenlight Capital (Gold), L.P., a portion of which reflects the modified high-water mark incentive allocation of 10%).

Performance returns are estimated pending the year-end audit. Past performance is not indicative of future results. Actual returns may differ from the returns presented. Each partner will receive individual returns from the Partnerships' administrator. Reference to an index does not imply that the Partnerships will achieve returns, volatility, or other results similar to the index. The total returns for the index do not reflect the deduction of any fees or expenses which would reduce returns.

All exposure information is calculated on a notional basis and does not include gold, credit default swaps, sovereign debt, cash, foreign currency positions, interest rate derivatives and other macro positions. Weightings, exposure, attribution and performance contribution information reflects estimates of the weighted average of Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., Greenlight Capital Offshore Partners, Greenlight Capital (Gold), L.P., and Greenlight Capital Offshore Master (Gold), Ltd. and are the result of classifications and assumptions made in the sole judgment of Greenlight. Positions reflected in this letter do not represent all the positions held, purchased, or sold, and in the aggregate, the information may represent a small percentage of activity. The information presented is intended to provide insight into the noteworthy events, in the sole opinion of Greenlight, affecting the Partnerships.

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