April 29, 2011

Dear Partner:

Greenlight Capital, L.P., Greenlight Capital Qualified, L.P. and Greenlight Capital Offshore (collectively, the "Partnerships") returned (2.5)%, (2.9)% and (3.2)%[1] net of fees and expenses, respectively, in the first quarter of 2011.[1]

Much like Charlie Sheen, who seems to believe that all publicity is good publicity, recent market behavior suggests that we are in the part of the cycle where "all news is good news." This was true for the broad market, which shrugged off the continued escalation of commodity prices, unrest in the Middle East, a catastrophe in Japan, tightening monetary policy outside the United States and a deceleration of domestic economic growth.

"All news is good news" was also true for individual stocks, including a number of our shorts. We expect to take some lumps when our shorts release strong earnings and their stock prices rise accordingly. Yet, this quarter we were repeatedly confuzzled when we read company news announcements that we expected to cause falling stock prices, only to see them rise instead – and sometimes sharply at that. Nonetheless, we believe that this environment is cyclical, and that it will continue this way… until it doesn't. Since we don't expect to be able to call the turn, we believe our best course is to concentrate on generating better alpha.

While our longs slightly outperformed the market, our shorts rose even more dramatically and our macro hedges were also in the red. While the price of gold was essentially unchanged during the quarter, we had modest losses in our various positions in currencies, interest rates and credit spreads. Nine of our ten largest winners were longs, with the largest being Delta Lloyd (up 24%), Arkema (up 19%), and Pfizer (up 16%). We did have a big short winner, a technology stock that fell 30%. Our five biggest losers were all shorts, including two consumer cyclicals, two energy-technology stocks, and Moody's Corp. (MCO).

One consumer cyclical short reported a surprisingly good fourth quarter result and we decided to cover. The other reported a barely adequate result, but announced a number of "strategic" initiatives. Though none of these initiatives appear likely to have a material impact on earnings, the market nonetheless liked the large font headlines and expanded the P/E multiple from high to borderline silly.

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[1] The returns for Greenlight Capital, L.P. and Greenlight Capital Qualified, L.P are net of the modified high-water mark incentive allocation of 10% and reflect the returns for partners who were invested on or prior to January 1, 2008. For partners who participated in our last capital opening and all partners in Greenlight Capital Offshore, their individual results will reflect our standard 20% incentive allocation.

We expect both energy-technology shorts to dramatically miss earnings forecasts this year. Unfortunately, both stocks spiked higher in response to the Japanese nuclear disaster, on the assumption that bad news in nuclear is good news for other competing, though less efficient, alternative energy products.

MCO advanced 28% in the quarter after announcing better than expected earnings. Most of the "surprise" was a one-time lower tax rate, but MCO made some operating improvements as well and its business environment has improved. Investors are focused on the near-term earnings strength, as MCO's ongoing litigation risk is unlikely to resolve any time soon.

We are in a particularly difficult environment for shorting stocks. In response, we have reviewed many of the names in our short portfolio. We covered more than a dozen lower confidence shorts during the quarter. We exited four successful shorts in the for-profit education industry, two foreign bank shorts (one at a small gain, the other at a large loss), a domestic bank short (at a loss), and a technology short (also at a loss). We also covered several others where performance exceeded our expectations. We kept our highest conviction older ideas (including MCO and St. Joe) and our highest conviction newer ideas (including the energy-technology stocks described above).

In addition, we exited successful long-term investments in Health Management Associates, Health Net Inc., and American General Finance bonds. We now have substantially liquidated our entire portfolio of stressed and distressed debt instruments that we purchased during the crisis.

For a couple of years we have speculated about a possible economic disaster in Japan. Of course, we did not expect a horrific earthquake, tidal wave and nuclear catastrophe. After the disaster, some economists have pointed to improved growth prospects as Japan rebuilds. To us, this seems like "broken-window" economics, and reflects a bias in how we keep score rather than economic progress or wealth creation. Japan has the worst positioned fiscal situation, demographics and growth prospects in the developed world. The "optimists" have maintained that Japan could carry on as long as it had a trade surplus and domestic savings to finance its fiscal deficit. The recent events put these two variables in doubt. In the aftermath, Japan will be unlikely to sustain a positive savings rate or a trade surplus. We will see whether the recent events prove to be a tipping point towards an economic crisis.

Here in the United States, our fears that quantitative easing would be a net harm to economic activity appear to be playing out. The prices of things people actually pay for including food, energy and healthcare continue to go up at an accelerated pace. While the corporate sector is flush with profits, consumers are being squeezed, and economic growth slowed during the first quarter. Though we are thankful that you can buy an iPad 2 (which we highly recommend!) for the same price as the old iPad, thus helping reduce our *published* inflation measures.

While Chairman Bernanke claims that quantitative easing has succeeded in raising stock prices, it seems that equities have gone up for the opposite reason he proposed. According to Mr. Bernanke, Federal Reserve purchases of government bonds were supposed to raise their

price so that they would be less attractive than other investments, including housing and equities. Investors would note the disparity and “rebalance” their portfolio to buy more houses and stocks, which would appear cheap compared to higher bond prices. This would support the housing recovery and make the equity market rise.

Instead, it appears that in response to quantitative easing, investors now fear inflation and have sold bonds. Interest rates have risen and housing prices have declined further. The housing recovery has faltered, creating another negative wealth effect and putting additional strain on the banking system. The money that the private sector would have lent to the government, had the Federal Reserve not printed the money instead, has gone to other goods, notably commodities and stocks to the extent investors see them as a better inflation hedge than bonds. Though the Federal Reserve has produced “research” that purports to show that quantitative easing has not caused commodity prices to rise, many observers disagree. As the Bank of Japan put it in March, “[I]t is safe to say that globally accommodative monetary conditions are a key driver of the rise in commodity prices by stimulating both physical demand for commodities and investment flows into commodity markets.”

A key question for the remainder of 2011 will be how consumers react to higher prices and how much of the cost pressure in the supply chain will be absorbed by the corporate sector. As Former Fed Chief Alan Greenspan put it, “there is no question that the momentum of this economy, leaving out the oil price issue, leaving out Euro problems that have emerged, and very specifically leaving out the budget problems, this economy is really beginning to pick up momentum… The fascinating issue for forecasters is, how do you factor in all the negatives?” Um, yeah.

We established three new significant long positions during the quarter.

Best Buy Inc. (BBY) operates consumer electronics stores in the U.S., Canada, Mexico, Europe and China. The market is concerned that BBY has reached its growth limits within the U.S. and faces declining video, laptop and television sales going forward. We believe that much of BBY’s recent problems were due to last year being a soft-goods holiday season that was particularly poor for televisions. Over the years we have seen many retailers given up for dead after a weak holiday result, only to recover with a change in fashion or product cycle. Bears believe that the internet puts BBY on a path to Blockbuster-video obsolescence. We think that view overstates the risk as there is value in store help, merchandising, service and being able to walk out of the store with your purchase. While BBY’s big box stores in the U.S. are mature (and, in fact, BBY will reduce its footage by a couple percent per year), we believe that BBY has more than offsetting growth opportunities in its Best Buy Mobile concept, international retail, and through additional higher-margin services offerings. In addition, the company currently has minimal leverage and between earnings and working capital improvements should generate almost a 20% free cash flow yield this year. BBY has targeted $1.3 billion of share repurchases this fiscal year, which is approximately 10% of its current market capitalization. The Partnerships established their position at an average price of $33.33 per share, representing a multiple of approximately 10x expected calendar 2011 earnings and less than 8x our estimate of 2012 earnings. BBY stock ended the quarter at

$28.72 per share. Based upon the price drop since our acquisition, this has not yet proven to be a *good buy*.

Delphi Automotive is an automotive supplier that produces a broad range of highly engineered products for powertrain, safety, electronic and thermal technology solutions. Delphi exited bankruptcy in October 2009 and has emerged in very good shape, following an aggressive restructuring in which it sold 11 businesses, closed 41 sites, reduced its U.S. workforce from 46,000 to 5,000 and moved its hourly pension plan and other post-employment benefits obligations to the Pension Benefit Guaranty Corporation (PBGC) and General Motors (GM). In addition, emerging markets have increased from 7% to 25% of sales.

The Partnerships established a position at an average price of $19,228 per share. To date, Delphi's multiple class ownership structure has limited its ability to go public. However, on March 31, 2011, Delphi repurchased shares from both GM and the PBGC for $4.4 billion, thereby creating a one class structure. There has since been press speculation that Delphi will pursue a public offering later this year. As Delphi potentially re-enters the public market, we hope that the company will gain value recognition for the significant progress it has made through its restructuring. Delphi stock ended the quarter at $21,500 per share.

The Partnerships established a new position in Yahoo! (YHOO) at an average cost of $16.93 per share. The company developed an extraordinary anti-shareholder reputation in recent years, beginning with its ill-advised decision in early 2008 to turn down Microsoft's equally ill-advised (and ill-timed) bid to buy the company for $31 per share. Now, under new management, YHOO has taken some increasingly shareholder-friendly steps. It has given up competing with Google in the web search business, a move which is improving free cash flow by reducing capex and operating expenses. It is using the improved cash flow to step up share repurchases (the company bought back more than 7% of its outstanding shares in 2010). YHOO is also taking steps to unlock value from some of its Asian assets in a tax efficient manner, including its 35% stake in publicly-traded Yahoo Japan.

YHOO currently has $3 per share of net cash on its balance sheet and has approximately another $8 per share of value in its two minority equity stakes of publicly traded companies in Asia (Yahoo Japan and Alibaba.com). Assigning a conservative valuation (5x current year EBITDA) implies $18 per share for just the core businesses and the publicly traded securities and cash. We believe that Yahoo's most valuable asset is its 40% stake in Alibaba Group's still-private holdings, which are separate and distinct from its ownership in the publicly-traded Alibaba.com, which we are essentially getting for free. Among Alibaba Group's privately held Chinese internet assets is a company called Taobao, which is the leading eCommerce website in China. More merchandise was sold on Taobao last year than on eBay, and Taobao's merchandise sales are growing 100% annually. We would not be surprised if YHOO's 40% stake in Alibaba Group alone was ultimately worth YHOO's entire current market value. YHOO stock ended the quarter at $16.68 per share.

We are pleased that Andrew Rechtschaffen has rejoined our investment team as an analyst. After a successful first tour of duty at Greenlight, Andrew set sail first for Citadel and later founded Obrem Capital. Ultimately, he decided to come back to Greenlight, presumably for reasons even beyond the superior lunch choices we offer on Seamless Web. Welcome back Andrew!

Gabe Marshank has joined Greenlight as an analyst in our London office. After graduating from Yale University, Gabe began his career in 1997 as a Research Analyst at Omega Advisors. In 1999 he joined Pequot Capital, moving in 2000 to their London office. In 2002 he joined SAC Capital in Connecticut where he worked as an analyst, relocating back to London in 2007. Over the past two years, Gabe helped launch and worked as senior analyst on RWC Partners' Biltmore Fund, a long-short fund based in London. Welcome Gabe!

The Dodd-Frank jobs program got a boost when we hired Sean Farrell to be our compliance officer, in preparation for our SEC registration later on this year. After serving in the Air Force and graduating from Rutgers University, Sean began his career at Deloitte & Touche. In 2003, Sean joined the SEC's New York office as a staff accountant, conducting regulatory compliance examinations. Sean left the SEC in 2006 to join ACA Compliance Group. In 2009, Sean joined Epoch Investment Partners as Chief Compliance Officer and, in September 2010, Sean joined Level Global Investors as Chief Compliance Officer. Sean is a Certified Public Accountant and a Certified Fraud Examiner. It turns out, that once you meet him, he is a really good guy. That is a particularly good thing, since he has access to all our e-mails. Welcome Sean!

We have a new baby to celebrate. To avoid confusing the baby, Alexandra finally changed her last name (a decision years in the making, going from Jennings to Jenkins). Baby William came into the world at 9 lbs. 11 oz. in February changing the old saying "Go big or go home" to "Go big and go home." Congratulations Alexandra!

At quarter end, the largest disclosed long positions in the Partnerships were Arkema, Delta Lloyd, gold, Pfizer and Vodafone Group. The Partnerships had an average exposure to equities and fixed income (excluding credit derivatives, gold and foreign currencies) of 106% long and 68% short.

"We will never embrace a strategy to weaken the dollar."

-- Tim Geithner

Best Regards,

Greenlight Capital

Greenlight Capital, Inc.