

DOWNSIDE PROTECTION REPORT

Edited by the Research Team of
Ideas
THE MANUAL OF

"Confronted with the challenge to distill the secret of sound investment into three words, we venture the motto: Margin of Safety." —Benjamin Graham

Stock Market Cheapness Snapshot

% of U.S. stocks trading for less than...	All stocks	MV > \$1bn
...net net current assets	8%	0%
...net cash	8%	2%
...tangible book value	34%	18%
...5x trailing EPS	9%	9%

Data as of December 5, 2008.

DECEMBER 2008 — IN THIS ISSUE:

Editor's Perspective:
The "Blue Chip" Myth

Top Investment Idea of the Month:
Greenlight Capital Re (GLRE)

Downside Protection Stock Screens:

- ▶ Top 10 stocks trading below net cash
- ▶ Top 10 stocks below tangible book
- ▶ Top 10 cheap repurchasers of stock

DOWNSIDE PROTECTION REPORT seeks out stocks with an exceptionally large margin of safety. Featured companies are judged to have minimal risk of permanent impairment, below-average price volatility and above-average capital appreciation potential.

The REPORT is published once each calendar month. Rather than publish on a specific date, we promise to bring you the report as soon as the top monthly idea is ready to be revealed.

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JOHN MIHALJEVIC, Managing Editor, is a hedge fund manager, former investment banker and equity analyst. He is a member of Value Investors Club, an exclusive community of top money managers, and has won the Club's prize for top investment idea. John is a trained economist and asset allocator, having studied under Yale Chief Investment Officer David Swensen and served as research assistant to Economics Nobel Laureate James Tobin. John holds a BA in Economics, *summa cum laude*, from Yale and is a CFA charterholder. He is married and resides in New York City.

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EDITOR'S PERSPECTIVE

The "Blue Chip" Myth

Downside protection used to be easy. Investors looking for a safe way of participating in the stock market could buy "blue chips" and sleep soundly at night. No longer. With staples such as General Motors (NYSE: GM), Citigroup (NYSE: C) and General Electric (NYSE: GE) down anywhere from 50% to more than 80% in the past year, it's clear that blue chips are no place to hide.

But the damage goes beyond temporary price declines. Several companies thought of as safe and stable until recently have suffered catastrophic—and, thanks to dilutive bailouts, almost certainly permanent—impairments of capital. The list includes giants American International Group (NYSE: AIG), Freddie Mac (NYSE: FRE) and Fannie Mae (NYSE: FNM).

CEOs and directors of a subset of the largest and most widely owned American corporations engaged in stunningly irresponsible risk taking during the recent period of over-leveraging and corporate excess. As we throw out all sorts of preconceived notions about self-regulating markets, the wisdom of our "best and brightest" business leaders and the capacity of government to protect our financial system, it is also time to throw out the term "blue chip."

Small caps are no panacea either. The Russell 2000 index of U.S. small-capitalization stocks (\$905 million average and \$345 million median market value) is down 39% year-to-date through December 5th. The Russell Microcap index of the smallest public companies (\$275 million average and \$100 million median market value) has fallen 44% during the same period.

What is a common stock investor to do, short of fleeing from the market altogether at an inopportune time, and short of resorting to strategies that involve short selling or option buying? With consistent effort and a focus on individual businesses rather than entire market segments, investors can take advantage of today's environment by investing in companies with low fundamental downside and large upside. Our task is to unearth such stocks—and bring them to you. As Warren Buffett once advised, be ready to profit from folly rather than participate in it.

This month's top investment idea, Greenlight Capital Re (GLRE), is judged to have superior downside protection and above-average upside. While the company is little known, it is overseen by David Einhorn, one of the most talented long/short fund managers in the world. The stock puts a "super investor" in charge of guiding your capital through a treacherous market environment—and at less than one times book value, you don't have to pay up for the privilege.

Sincerely,



John Mihaljevic, CFA
Managing Editor ✍

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**Greenlight Capital Re, Ltd.
(Nasdaq: GLRE)**

Financial: Insurance (Property & Casualty)
Grand Cayman, Cayman Islands, 345-745-4573
<http://www.greenlightre.ky>

Fair Value Range

MOI estimate (page 6): \$18-24 / share

Trading Data

Recent price: \$10.85
52-week range: \$8.67 - \$23.85
Market value: \$394 million
Shares outstanding: 36.3 million

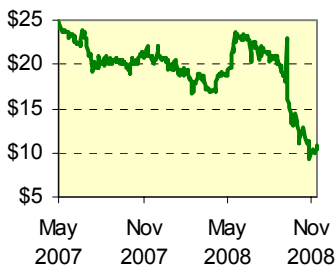
Trading Multiples

Price to book value: 0.8x
P/E (LTM 9/30/08): n/m
P/E (FYE 12/31/07): 9.4x

Ownership Data

Insider ownership: 20%
Insider buys / sales:¹ 2 / 0
Institutional ownership: 42%

Stock Price Performance Since IPO



¹ Number of transactions in past six months.

ANALYSIS OF GREENLIGHT RE:

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THIS MONTH'S TOP PICK

**Greenlight Capital Re, Ltd. (Nasdaq: GLRE):
Let David Einhorn Pick Winners for You — Long *and* Short**

An investment in Greenlight Re should outperform the market in times both good *and* bad, due to David Einhorn’s superior investment skill and Greenlight’s strategy of selling stocks short in addition to buying them. We estimate fair value at \$18-24 per share, based on the analysis presented in this report.

39-year-old David Einhorn has had phenomenal success managing Greenlight Capital (not the same legal entity as Greenlight Capital Re), a value-oriented hedge fund that has grown into a billion dollar firm from humble beginnings, with only \$1 million in assets in 1996. While returns have suffered this year, we estimate that Greenlight has delivered an annualized return since inception, net of all fees and expenses, of more than 20%. This is an impressive feat considering that the fund navigated through both the bursting of the Internet bubble in 2001-02 and the ongoing U.S. credit contraction and recession. Also impressive is the fact that Einhorn achieved such returns while maintaining relatively low net exposure to equity markets, due to a strategy of buying undervalued stocks and selling short overvalued, mismanaged or downright fraudulent companies.

Greenlight Re went public in May 2007 as a publicly traded version of Einhorn’s hedge fund, with several enhancements:

- **Tax-advantaged structure** by virtue of Cayman Islands domicile, making Greenlight Re a pass-through vehicle for U.S. investors.
- **Reinsurance underwriting should add value**, an aspect that is unique to Greenlight Re as compared to Einhorn’s hedge fund. Underwriting is conservative, with significant unutilized capacity and most premiums related to frequency rather than severity business.
- **Investors may sell their shares in the open market at any time**, a liquidity benefit not available to hedge fund investors.
- **Repurchases should accelerate growth of per-share value**, as Greenlight Re may buy back stock at a discount in times of market distress. The Board authorized a two million-share buyback in August.
- **Investors should benefit from price-to-book multiple expansion** over time, as the market comes to appreciate Einhorn’s investment skill. This may allow investors buying at current prices and selling in the future to get paid for the discounted value of Einhorn’s “alpha.”

Einhorn is incentivized to grow shareholder value, as he owns 17% of Greenlight Re. He also has a track record of fair treatment of investors.

We judge Greenlight Re shares to have superior downside protection due to (1) their discount to book value, (2) Einhorn’s proven ability to generate investment outperformance, (3) a conservative underwriting posture, (4) an ability to repurchase shares below fair value, thereby limiting the downside and increasing future upside, and (5) an ability to go long as well as short in the stock market, enabling Greenlight to seize opportunities regardless of overall market direction.

BUSINESS OVERVIEW

Greenlight Re is a reinsurer whose investment portfolio is managed by David Einhorn's investment firm. Greenlight Re provides custom-tailored specialty property and casualty reinsurance to the insurance, risk retention group, captive, and financial markets. Established in 2004, Greenlight Re selectively offers customized solutions in markets where capacity and alternatives are limited. The company has a goal of maximizing long-term growth in book value per share.

SELECTED OPERATING DATA

(\$ in millions)	YTD			
FYE December 31	2005	2006	2007	9/30/08
<i>Gross premiums written by risk category:</i> ¹				
Frequency	--	\$58	\$77	\$105
Severity	--	16	50	28
Total	--	\$74	\$127	\$134
<i>Gross premiums written by line of business:</i>				
Property ²	--	\$68	\$59	\$10
Casualty ³	--	6	46	67
Specialty ⁴	--	0	23	57
<i>Gross premiums written by geographic area of risk:</i>				
U.S.	--	\$64	\$80	\$114
Non-U.S.	--	5	3	1
Worldwide ⁵	--	4	45	19
<i>Selected underwriting ratios (based on GAAP results):</i> ⁶				
Loss ratio	--	36%	40%	45%
Acquisition cost ratio	--	39%	40%	39%
Internal expense ratio	--	34%	12%	14%
Combined ratio	--	110%	92%	97%
Investment return ⁷	14%	24%	6%	-13%
Book value per share	\$11.63	\$14.27	\$16.57	\$14.22
Change (y-y)	14%	23%	16%	-10%

¹ Retrocessional contracts related to frequency reinsurance had gross ceded premiums of \$26 million in 2007 (no retrocessional coverage in 2006).

² Includes commercial lines and personal lines.

³ Includes General liability, marine, motor liability, and professional liability.

⁴ Includes health and medical malpractice.

⁵ Worldwide risk comprises policies that insure risks on a worldwide basis.

⁶ The composite ratio of frequency and severity business was 94% and 42%, respectively, in 2007 (compared to 97% and 45%, respectively, in 2006).

⁷ Investment return was -13% in October and +3% in November 2008.

⁸ Numerator includes assumed proceeds from future exercise of stock options.

INVESTMENT HIGHLIGHTS

- **David Einhorn is one of the most successful investors of the past decade.** Since inception in 1996, Greenlight Capital's flagship long-short fund has posted annualized net returns of 20+%.*
- **Focus on superior returns from both sides of balance sheet.** Traditional reinsurers focus primarily on one side of the balance sheet, seeking to grow their underwriting businesses while managing their float portfolio primarily for avoidance of loss or drastic underperformance. This results in most reinsurers making large investments in high-grade fixed-income and other low-yielding securities. Greenlight Re, on the other hand, appears likely to derive at least as much value from its investment activities as it may from underwriting.
- **Favorable tax treatment due to Cayman Islands location.** Greenlight Re pays income taxes neither in the Cayman Islands nor in the U.S., effectively making it a "pass-through" entity for investors.

* Source: *The Manual of Ideas* estimates.

- **Disciplined, differentiated underwriting strategy.** Greenlight Re offers excess of loss and quota share products in the property and casualty market, focusing on customized solutions rather than participating in broadly available opportunities. The company seeks to maximize long-term results rather than manage for interim or GAAP performance. Management is compensated based on multi-year underwriting performance rather than premium volume or short-term results. Greenlight Re seeks to act as lead underwriter for most premiums written.
- **Business sourced mostly through reinsurance brokers,** providing the company with variable-cost global distribution (commissions are based on gross premiums written). Brokers have no authority to bind the company to any reinsurance contract.
- **A- (excellent) financial strength rating from A.M. Best** — the 4th-highest of 15 ratings. The outlook is stable. The rating assumes that the investment portfolio may be 100% in equities. Greenlight Re has an unencumbered balance sheet, with book value of \$518 million and liabilities of \$598 million at Q3-end (includes \$370 million of securities sold short in the investment portfolio).
- **"Cradle to grave" service philosophy,** with reinsurance contracts administered by the same individuals who underwrote the contracts.
- **No direct "open-end fund" risk.** Greenlight Re's equity base is committed and cannot be withdrawn, unlike assets in a mutual or hedge fund. As such, Greenlight Re can invest almost exclusively for long-term return maximization. (We note that Einhorn's hedge fund is open-ended—withdrawals there could pressure Re's mark-to-market portfolio.)
- **Little leverage in investment operations.** While Greenlight's portfolio entails some gross leverage due to short-selling activities, net exposure is typically well below 100% of net equity. The low leverage lowers the long-term risk profile.
- **\$50 million personal investment by Chairman David Einhorn.** Einhorn purchased Class B shares at the IPO price of \$19 per share in conjunction with the company's public offering in May 2007. While Einhorn has certain conflicts of interest in his various roles, the purchase of shares indicates his commitment to the success of Greenlight Re. We also note Einhorn's strong track record of creating value for his hedge fund investors. Einhorn's management fee of 1.5% is below the industry "standard" of 2.0%, despite the fact that Einhorn's superior performance may warrant a higher fee.
- **Share repurchase authorized in August.** The Board authorized a buyback of two million shares. We view buybacks at multiples of less than 1.5x book value as accretive to intrinsic value per share.
- **Shares trade at 0.8x diluted book value.**

INVESTMENT RISKS & CONCERNS

- **Limited loss experience.** While Greenlight Re has an experienced management team, the company has paid relatively few claims to date, and it is difficult to evaluate the appropriateness of loss reserves.
- **Exposure to natural disasters.** The maximum aggregate loss exposure to any series of natural peril events was \$76 million at yearend 2007.
- **Underwriting dependent on A.M. Best rating.** Should A.M. Best downgrade the company—either as a result of higher-than-expected losses on policies, or large losses in the fairly concentrated investment portfolio—Greenlight Re may become unable to write new business on favorable terms.
- **Needs to maintain letters of credit to write certain business,** as the company is licensed and admitted as a reinsurer in the Cayman Islands only. Many banks prefer fixed-income collateral to the company’s non-traditional investment portfolio.
- **Risk of Passive Foreign Investment Company treatment.** PFIC investors face adverse U.S. tax consequences. Greenlight Re does not believe it is a PFIC, as the determination criteria exclude income derived while conducting an insurance business.
- **Competitive industry.** Both the reinsurance and investment management industries are highly competitive, and perceived sustainable competitive advantage often proves fleeting. Nonetheless, we believe Greenlight Re enjoys a sustainable advantage on the investment side, and it is likely to do above average on the underwriting side.

COMPARABLE PUBLIC COMPANY ANALYSIS

	Price (\$)	Market Value (\$mn)	Price to Tangible Book	CY08 P/E	CY09 P/E
ACE	51.83	17,290	1.5x	7x	7x
AIG	1.94	5,219	0.1x	n/m	2x
BRK.A	102,700	159,101	1.8x	18x	17x
CB	51.85	18,443	1.4x	9x	9x
FFH	272.44	4,991	1.1x	n/a	n/a
MKL	297.90	2,923	1.5x	18x	13x
PRE	72.76	4,005	1.1x	7x	7x
TRH	37.58	2,491	0.8x	7x	6x
TRV	43.41	25,374	1.2x	8x	8x
XL	6.05	2,001	0.3x	2x	2x
LUK	18.55	4,320	0.8x	n/a	n/a
GLRE	10.85	394	0.8x	n/a	n/a

MAJOR HOLDERS

Chairman David Einhorn 17% | CEO Len Goldberg 1% | Other insiders 1% | Khronos 8% | Morgan Stanley 7% | Montpellier 6% | Royal Capital 4% | Third Point 2%

RATINGS

- VALUE** Intrinsic value materially higher than market value? ☆☆☆☆☆
- MANAGEMENT** Capable and properly incentivized? ☆☆☆☆☆
- FINANCIAL STRENGTH** Solid balance sheet? ☆☆☆☆☆
- MOAT** Able to sustain high returns on invested capital? ☆☆☆☆☆
- EARNINGS MOMENTUM** Fundamentals improving? ☆☆☆
- MACRO** Poised to benefit from economic and secular trends? ☆☆☆☆☆
- EXPLOSIVENESS** 5%+ probability of 5x upside in one year? ☆☆☆

THE BOTTOM LINE

Greenlight Re is essentially an investment fund “on steroids”:

- The company’s portfolio is managed by David Einhorn’s Greenlight Capital, a top-notch investment firm in terms of long-term risk-adjusted performance.
- Greenlight Re has a tax-advantaged structure by virtue of its Cayman Islands domicile, making it a pass-through vehicle for U.S. investors.
- The company’s goal is to create value on both sides of the balance sheet. Reinsurance underwriting should add value over time, an aspect that is unique to Greenlight Re as compared to other vehicles managed by Einhorn.
- Greenlight Re investors have the option to sell their shares in the open market at any time, a liquidity benefit not available to hedge fund investors.
- Greenlight Re investors are likely to benefit from price-to-book multiple expansion over the long term, as public market investors come to appreciate Einhorn’s track record. This may allow investors buying at current prices—which are only modestly above book value—to get paid for the discounted present value of Einhorn’s superior investment skills at the time of sale of their shares of Greenlight Re.
- With Einhorn owning 17% of Greenlight Re, he is incentivized to add value over the long term. We also note Einhorn’s track record of both strong investment performance and fair treatment of investors.

Our valuation analysis (included below) suggests fair value of \$18-24 per share, based on book value multiples of 1.4x-1.9x. We believe an investment in Greenlight Re at current prices should outperform handily in the long term, and may even be preferable to a direct investment in one of Einhorn’s hedge funds.

BOOK VALUE MULTIPLE—WHAT IS “FAIR”?

We argue that Greenlight Re deserves to trade at a premium to book value due to the likelihood that Greenlight’s investment portfolio, managed by David Einhorn, will beat the market over time.



Download model and test alternative assumptions in members-only area of www.manualofideas.com

- As the following table shows, Greenlight Re may deserve a book value multiple of 2.1x, assuming a 12% net investment return for Greenlight versus 8% for the broader market and a 20-year horizon of outperformance. Assuming outperformance over the next ten years only, the fair value multiple drops to 1.4x.

Analysis of Fair Book Value Multiple Assuming 12% Long-Term Investment Return vs. 8% Market Return ⁽¹⁾

	Compounding of \$1 at Selected Rates of Return		Performance Difference		Current "Fair" Multiple of Book Value Based on Length of Assumed Future Outperformance
	12%	8%	Future Value	Present Value (8% rate)	
Year 0	\$1.00	\$1.00			
Year 1	1.12	1.08	\$0.04	\$0.04	1.0x
Year 2	1.25	1.17	0.09	0.08	1.1x
Year 3	1.40	1.26	0.15	0.12	1.1x
Year 4	1.57	1.36	0.21	0.16	1.2x
Year 5	1.76	1.47	0.29	0.20	1.2x
Year 6	1.97	1.59	0.39	0.24	1.2x
Year 7	2.21	1.71	0.50	0.29	1.3x
Year 8	2.48	1.85	0.63	0.34	1.3x
Year 9	2.77	2.00	0.77	0.39	1.4x
Year 10	3.11	2.16	0.95	0.44	1.4x
Year 11	3.48	2.33	1.15	0.49	1.5x
Year 12	3.90	2.52	1.38	0.55	1.5x
Year 13	4.36	2.72	1.64	0.60	1.6x
Year 14	4.89	2.94	1.95	0.66	1.7x
Year 15	5.47	3.17	2.30	0.73	1.7x
Year 16	6.13	3.43	2.70	0.79	1.8x
Year 17	6.87	3.70	3.17	0.86	1.9x
Year 18	7.69	4.00	3.69	0.92	1.9x
Year 19	8.61	4.32	4.30	1.00	2.0x
Year 20	9.65	4.66	4.99	1.07	2.1x

- As the following table shows, Greenlight Re may deserve a book value multiple of 3.5x, assuming a 15% net investment return for Greenlight versus 8% for the broader market and a 20-year horizon of outperformance.
- It is reasonable to cap the fair value multiple at 2x-3x, as the company may issue stock at higher multiples in order to “arbitrage” the spread between market value and book value.

Analysis of Fair Book Value Multiple Assuming 15% Long-Term Investment Return vs. 8% Market Return ⁽¹⁾

	Compounding of \$1 at Selected Rates of Return		Performance Difference		Current "Fair" Multiple of Book Value Based on Length of Assumed Future Outperformance
	15%	8%	Future Value	Present Value (8% rate)	
Year 0	\$1.00	\$1.00			
Year 1	1.15	1.08	\$0.07	\$0.06	1.1x
Year 2	1.32	1.17	0.16	0.13	1.1x
Year 3	1.52	1.26	0.26	0.21	1.2x
Year 4	1.75	1.36	0.39	0.29	1.3x
Year 5	2.01	1.47	0.54	0.37	1.4x
Year 6	2.31	1.59	0.73	0.46	1.5x
Year 7	2.66	1.71	0.95	0.55	1.6x
Year 8	3.06	1.85	1.21	0.65	1.7x
Year 9	3.52	2.00	1.52	0.76	1.8x
Year 10	4.05	2.16	1.89	0.87	1.9x
Year 11	4.65	2.33	2.32	1.00	2.0x
Year 12	5.35	2.52	2.83	1.12	2.1x
Year 13	6.15	2.72	3.43	1.26	2.3x
Year 14	7.08	2.94	4.14	1.41	2.4x
Year 15	8.14	3.17	4.96	1.57	2.6x
Year 16	9.36	3.43	5.93	1.73	2.7x
Year 17	10.76	3.70	7.06	1.91	2.9x
Year 18	12.38	4.00	8.38	2.10	3.1x
Year 19	14.23	4.32	9.92	2.30	3.3x
Year 20	16.37	4.66	11.71	2.51	3.5x

(1) Analysis assumes that entire book value participates in performance of investment portfolio. Adjusting this assumption downward would also result in a downward adjustment to the current fair multiple of book value.

WHAT ARE THE SHARES WORTH?

- **We value GLRE at \$18-24 per share**, based on fair value multiples of book of 1.4x-1.9x. We believe this to be a conservative range, based on expected long-term investment outperformance.
- *At the low end*, we assume that outperformance persists for the next 10 years, with net returns of 12% per year versus market returns of 8% per year.
- *At the high end*, we assume that outperformance persists for the next 10 years, with net returns of 15% per year versus market returns of 8% per year.
- **Underwriting:** Our value estimate assumes that reinsurance underwriting operations neither create nor impair material shareholder value over time. We believe this to be a conservative assumption.
- **Share repurchases:** Our value estimate assumes that management does not increase per-share intrinsic value through opportunistic buybacks. We believe this to be a very conservative assumption, as the company has commenced a buyback program.

Greenlight Capital Re — Valuation Summary

	Fair Value Range	
	Low	High
Diluted book value per share at 9/30/08	\$14.22	\$14.22
Q4 investment result (through 11/30/08)	-9.7%	-9.7%
Estimated decline in per-share book value	-11.7%	-9.7%
Estimated book value at 11/30/08	\$12.56	\$12.84
Fair value multiple of book value	1.4x	1.9x
Estimated per-share value of GLRE	\$17.58	\$24.40

Source: Company filings, *The Manual of Ideas* estimates and analysis.

WHY THE SHARES MAY BE MISPRICED

- **Investors myopically focused on recent losses.** In predictable fashion, the market has abandoned Greenlight Re during a period of weak investment results, ignoring Einhorn’s track record and likely future outperformance. Conceptually, the ideal time to buy into any “closed-end” vehicle managed by a top-notch investor is during a temporary period of underperformance, as the vehicle might be available at a big discount to fair value — this is such a time.
- **Investors ignore the fact that recent losses are “good” in the context of S&P 500 performance.** Greenlight Re’s investment portfolio is down 21% YTD through the end of November, versus a decline of 38% for the S&P 500 (total return index). While it’s true that the performance of Greenlight’s long/short portfolio might be more appropriately measured against short-term government yields, the point is that Einhorn’s investment skill has enabled Greenlight to outperform major stock market indices in times good *and* bad. There is no reason to believe this will change. In fact, recent market turmoil has likely taught Einhorn some important lessons and made him a better investor.

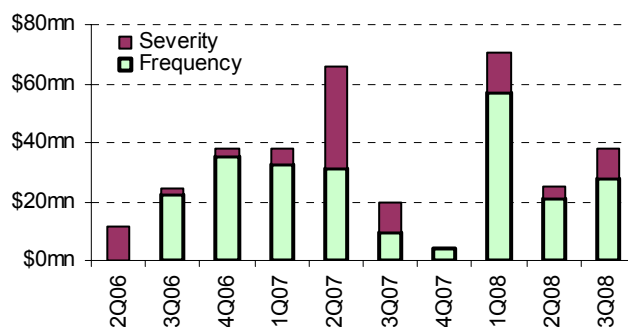
NEAR-TERM CATALYSTS

- **Strong quarter of investment performance may lead to swift price-to-book revaluation**, as investor skiddishness about Einhorn might be alleviated. While timing is speculative, Greenlight could turn around results as early as 1Q09.
- **Second-largest recent investment loser has high likelihood of turning into winner.** Greenlight has suffered large mark-to-market losses from a long/short trade in Porsche and Volkswagen shares. While this trade has been a spectacular failure to date, we have developed high conviction in this position through our own research. As a result, we believe Greenlight will be vindicated—possibly in the next few months—providing a major positive catalyst to investment performance. We note that Greenlight is not at the mercy of margin calls due to a policy of avoiding portfolio leverage.

SELECTED OPERATING DATA AND METRICS

GLRE – Gross Premiums Written, 2Q06-3Q08

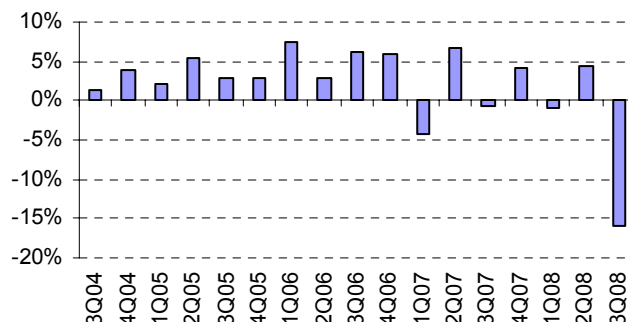
The company has succeeded in the goal of making frequency business a large percentage of overall underwriting volume, thereby lowering exposure to catastrophe losses. In addition, as the volatility of underwriting volume suggests, management has been disciplined and opportunistic about the kind of business it has written. The company’s stated goal is not to grow premium volume but to seek out business with favorable risk-return characteristics.



Source: Company, *The Manual of Ideas*.

GLRE – Net Investment Performance, 3Q04-3Q08

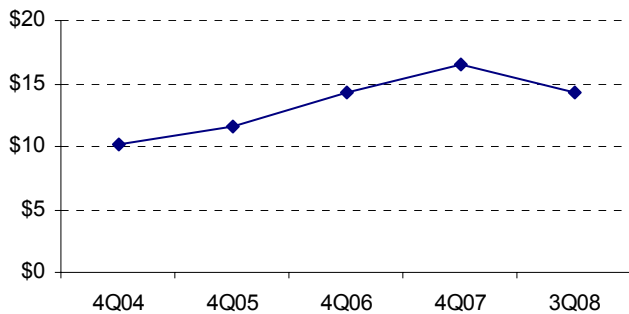
Greenlight Re reported positive investment performance in 14 of the 17 quarters since it commenced investment operations in 3Q04. Prior to the 3Q08 record loss of 16%, the largest quarterly investment loss was 4% in 1Q07. Annual data is as follows: +5% in 2004, +14% in 2005, +24% in 2006, +6% in 2007, -21% in 2008 (through 11/30).



Source: Company, *The Manual of Ideas*.

GLRE – Diluted Book Value per Share, FY 2000-08

Diluted book value per share declined 10% during the twelve months ended September 30, 2008 and by another ~10% so far in 4Q08 (down sharply in October, rebounded modestly in November). Book value per share grew 14% in 2005, 23% in 2006 and 16% in 2007, driven primarily by positive investment performance.



Source: Company, *The Manual of Ideas*.

NOTES FROM Q3 EARNINGS CALL

November 5, 2008; with Chairman David Einhorn, CEO Len Goldberg, President and Chief Underwriting Officer Bart Hedges, and CFO Tim Courtis

To listen to a replay of the call, visit <http://tinyurl.com/moi123>

General comments:

- **Objective:** preserve capital and maximize risk-adjusted returns on both sides of balance sheet; long-term growth in diluted book value per share is most important metric
- **Q3:** good quarter for underwriting portfolio, bad quarter for investment portfolio
- **Outlook:** “remain in strong position” to take advantage of any market dislocations; see “hardening” insurance market in 2009 and beyond
- **Credit rating:** AM Best has confirmed that events through the end of October “will not create any issues” related to A- (“excellent”) rating, and that “we are currently more than adequately capitalized, even under significant stress testing” (note that investment portfolio was up 3.4% in November)
- **Stock repurchases:** no comments provided

Financial results:

- **Q3:** reported loss due to investment portfolio loss
- See next page for more financial metrics

Reinsurance underwriting:

- **Strategy:** diversify portfolio by growing frequency versus severity business → underwriting program should be less volatile over time than that of catastrophe-focused reinsurers
- **Q3:** premiums written increased; frequency business accounted for 79% of premium volume at Q3-end, up from 59% a year ago; did not suffer losses from hurricanes Ike and Gustav
- **Loss outlook:** industry-wide directors & officers (D&O) liabilities to increase due to downturn and credit crisis—Greenlight has limited D&O exposure

- **Pricing:** “price of risk has increased everywhere;” expect pricing to improve, “in some cases dramatically so;” seeing signs of hardening in natural catastrophe business — may expand portfolio opportunistically in 2009; casualty “much less clear at the moment... pricing will increase but not necessarily immediately; in fact, original pricing in some of this business could go down in the short term as the healthier insurers compete for market share at the expense of less healthy companies—we will tread carefully”
- **Growth:** large potential client base of specialist organizations that “we believe we will be able to selectively add to the portfolio over time”
- **Financial strength:** premium-to-capital ratio is “among the most conservative in the industry”

Investment portfolio:

- **Q3:** “extremely disappointed” with -16% result; portfolio was 17% net long through Q3 but had too much gross exposure (lowered in September); long portfolio suffered from widespread deleveraging and “analytical errors in a couple of names”
- **October:** entered month with “small positive net exposure;” nonetheless, lost 13% due to decline in long position Helix Energy (HLX) (hurt by declining oil prices and Gulf Coast hurricanes) and losses related to “relatively small position” in Porsche stub (long Porsche, short Volkswagen)
- **As of November 5th:** more net long than in early October; “remain long cash flow positive companies with generally unlevered balance sheets that we believe have already priced in a severe downturn;” “continue to be short companies that we believe will be challenged given the real and present headwinds the economy faces today,” especially big financials

Q&A:

- **Credit facility:** \$400 million letter of credit facility with Citigroup, renewable annually
- **Impact of currency on Q3 investment loss:** fluctuations might have slightly benefited results
- **Current position in Porsche stub:** no comment due to practice of not disclosing real-time portfolio

RECOMMENDED READING

- Greenlight Capital Re write-up at Value Investors Club, April 2008.
Visit <http://www.valueinvestorsclub.com> (free registration required).
- Insight into Greenlight’s investment portfolio: David Einhorn’s October 2008 letter to investors.
Visit <http://tinyurl.com/moi124>
- David Einhorn, *Fooling Some of the People All of the Time: A Long Short Story*, Wiley, 2008.
Preview at <http://foolingsomepeople.com> or order at <http://tinyurl.com/moi125>


SELECTED OPERATING DATA AND DRIVERS

(\$ in millions, except per share data)

	FYE December 31,			YTD		3Q07	3Q08
	2005	2006	2007	9/30/07	9/30/08		
<i>Gross premiums written by risk category: (1)</i>							
Frequency	--	\$58	\$77	\$73	\$105	\$9	\$28
Severity	--	16	50	50	28	11	10
Total gross premiums written	--	\$74	\$127	\$123	\$134	\$20	\$38
<i>Gross premiums written by line of business:</i>							
Property (2)	--	\$68	\$59	\$57	\$10	\$16	\$8
Casualty (3)	--	6	46	48	67	3	18
Specialty (4)	--	0	23	19	57	0	12
<i>Gross premiums written by geography of risk:</i>							
U.S.	--	\$64	\$80	\$76	\$114	\$9	\$28
Non-U.S.	--	5	3	3	1	0	0
Worldwide (5)	--	4	45	45	19	11	10
<i>Net premiums written by risk category:</i>							
Frequency	--	\$58	\$51	\$45	\$92	\$9	\$29
Severity	--	16	50	50	28	11	10
Total net premiums written	--	\$74	\$101	\$95	\$120	\$20	\$39
<i>Selected underwriting ratios (GAAP): (6)</i>							
Loss ratio	--	36%	40%	41%	45%	37%	52%
Acquisition cost ratio	--	39%	40%	40%	39%	44%	43%
Internal expense ratio	--	34%	12%	12%	14%	11%	12%
Combined ratio	--	110%	92%	93%	97%	91%	106%
<i>Selected ratios -- frequency (GAAP):</i>							
Loss ratio	--	56%	48%	49%	35%	43%	24%
Acquisition cost ratio	--	41%	46%	45%	53%	49%	59%
Composite ratio -- frequency	--	97%	94%	94%	89%	92%	84%
<i>Selected ratios -- severity (GAAP):</i>							
Loss ratio	--	9%	20%	15%	64%	20%	128%
Acquisition cost ratio	--	37%	22%	25%	9%	29%	-4%
Composite ratio -- severity	--	45%	42%	40%	73%	49%	124%
Investment return (7)	14%	24%	6%	1%	-13%	-1%	-16%
Net income	\$26	\$57	\$35	\$6	(\$90)	(\$2)	(\$118)
EPS	1.24	2.66	1.15	0.21	(2.49)	(0.06)	(3.29)
Diluted shares outstanding (avg)	21	21	31	29	36	36	36
Diluted shares outstanding (period end)	22	23	38	36	36	36	36
Cash and equivalents	\$7	\$83	\$64	\$120	\$216	\$120	\$216
Restricted cash and equivalents	100	155	372	404	400	404	400
Investments in securities	219	244	591	492	389	492	389
Other assets	2	38	68	91	111	91	111
Total assets	\$328	\$519	\$1,094	\$1,107	\$1,117	\$1,107	\$1,117
Shareholders' equity	232	312	606	576	518	576	518
Equity to assets	71%	60%	55%	52%	46%	52%	46%
Diluted book value per share (8)	\$11.63	\$14.27	\$16.57	\$15.78	\$14.22	\$15.78	\$14.22
Change (y-y)	14%	23%	16%	n/a	-10%	n/a	-10%

(1) Retrocessional contracts related to frequency reinsurance had gross ceded premiums of \$26 million in 2007 (no coverage in 2006).

(2) Includes commercial lines and personal lines.

(3) Includes General liability, marine, motor liability, and professional liability.

(4) Includes health and medical malpractice.

(5) Worldwide risk comprises policies that insure risks on a worldwide basis.

(6) The composite ratio of frequency and severity business was 94% and 42%, respectively, in 2007 (compared to 97% and 45% in 2006).

(7) Subsequent to 3Q08, investment return was -13% in October and +3% in November 2008.

(8) Numerator includes assumed proceeds from future exercise of stock options.

DOWNSIDE PROTECTION SCREEN #1 — Companies Trading For Less Than Cash

Objective: Find stocks trading close to liquidation value. Cash burn must be slow or nonexistent. Insiders must not have controlling stakes.
Screening criteria: ▶ Market value less than net cash and investments ▶ Current assets greater than total liabilities ▶ At least as much insider buying as selling in past six months (both shares and transactions) ▶ Insider ownership less than 25% ▶ Positive LTM EBIT, or LTM loss equal to less than 10% of net cash balance, or estimated forward EPS not negative ▶ Market value greater than \$50 million
Sorted by: Net cash to market value | **Units:** U.S. dollars in millions, except as otherwise stated

Company / Ticker	Price (\$)	Market Value	Net Cash	Total Liab.	LTM EBIT	Cash/MV	ST Assets/ Total Liab.	Insider Own.	# of Insider	
									Buy	Sell
Trident Microsystems / TRID	1.65	103	230	75	-20	223%	342%	1%	-	-
Actions Semiconductor / ACTS	1.45	123	258	25	29	210%	>999%	2%	-	-
Comverse Technology / CMVT	5.28	1,067	1,809	1,193	89	170%	238%	0%	-	-
Seanergy Maritime / SHIP	5.08	145	234	7	-1	161%	>999%	10%	-	-
KHD Humboldt Wedag / KHD	8.37	255	395	496	86	155%	143%	22%	-	-
Opnext / OPXT	1.76	114	170	100	3	150%	366%	12%	-	-
Novatel Wireless / NVTL	3.15	96	136	72	15	143%	322%	0%	-	-
ORBCOMM / ORBC	1.48	62	87	34	-3	140%	280%	24%	-	-
Sierra Wireless / SWIR	5.02	155	202	107	49	130%	309%	1%	-	-
Clarus / CLRS	4.60	80	86	1	-5	108%	>999%	14%	8	-

[DownsideProtection1 • DownsideProtection • downside_protection.xls • dp1]

DOWNSIDE PROTECTION SCREEN #2 — Companies Trading For Less Than Tangible Book Value

Objective: Find stocks trading below tangible net worth. Companies must have little or no debt and positive trailing or forward earnings
Screening criteria: ▶ Market value less than tangible book value ▶ Current assets greater than total liabilities ▶ At least as much insider buying as selling in past six months (both shares and transactions) ▶ Net debt to equity of less than 10% ▶ Positive trailing operating income or non-negative estimated forward EPS ▶ Market value greater than \$100 million
Sorted by: Market value | **Units:** U.S. dollars in millions, except as otherwise stated

Company / Ticker	Price (\$)	MV	EV	Net Debt/ Equity	TBV/ MV	LTM EBIT	Insider Own.	# of Insider	
								Buy	Sell
Panasonic / PC	11.46	23,741	17,006	-17%	141%	5,732	10%	-	-
Kyocera / KYO	62.18	11,806	6,116	-37%	122%	2,698	10%	-	-
FUJIFILM / FUJI	22.51	11,358	11,236	-1%	142%	1,950	8%	-	-
LG Display / LPL	7.36	5,249	5,642	6%	123%	2,079	58%	-	-
TDK / TDK	28.25	3,645	3,057	-8%	183%	610	8%	-	-
Sterlite Industries / SLT	4.67	3,309	3,451	3%	143%	1,307	61%	-	-
Magna International / MGA	28.89	3,253	1,541	-21%	212%	605	19%	-	-
Yanzhou Coal Mining / YZC	5.37	2,641	1,389	-35%	127%	1,132	53%	-	-
Makita / MKTAY	17.54	2,470	1,624	-25%	135%	752	17%	-	-
Patterson-UTI Energy / PTEN	9.64	1,491	1,466	-1%	134%	543	1%	-	-

[DownsideProtection2 • DownsideProtection • downside_protection.xls • dp2]

DOWNSIDE PROTECTION SCREEN #3 — Cheap Companies Buying Back Their Own Stock

Objective: Find stocks that are cheap based on book value or earnings and are increasing per-share value through stock repurchases.
Screening criteria: ▶ Shares outstanding down more than 2.5% sequentially in latest quarter ▶ Market value less than 1.5x tangible book or forward P/E of less than 10x ▶ At least as much insider buying as selling in past six months (both shares and transactions) ▶ Net debt to equity of less than 10% ▶ Positive LTM EBIT or non-negative 2009E EPS ▶ Market value greater than \$100 million
Sorted by: Market value | **Units:** U.S. dollars in millions, except as otherwise stated

Company / Ticker	Price (\$)	MV	EV	LTM EBIT	TBV/ MV	Forward P/E	Insider Own.	# of Insider	
								Buy	Sell
Philips / PHG	16.13	15,685	17,607	1,708	52%	8x	1%	-	-
Coach / COH	19.69	6,437	6,030	1,142	17%	8x	1%	7	1
Garmin / GRMN	17.47	3,538	2,999	939	54%	5x	46%	10	-
Endo Pharmaceuticals / ENDP	22.23	2,984	2,696	342	21%	9x	2%	1	1
Lexmark / LXX	25.61	2,008	1,570	391	53%	9x	0%	2	2
Aspen Insurance / AHL	21.47	1,749	1,257	258	150%	5x	2%	-	-
IPC Holdings / IPCR	29.12	1,361	1,305	214	134%	6x	0%	-	-
Montpelier Re / MRH	14.39	1,317	1,097	1	107%	6x	9%	-	-
Tech Data / TECD	16.07	804	849	216	207%	8x	2%	-	-
Carpenter Technology / CRS	15.11	666	594	436	110%	4x	1%	3	3

[DownsideProtection3 • DownsideProtection • downside_protection.xls • dp3]

YOU MAY BE WONDERING...

This month's top pick is down a lot in the past year. How can you assert that a stock that has fallen so precipitously has "superior downside protection"?

Our assessment is based on protecting your capital *from this point forward*. It is quite unlikely that we would have recommended the stock a year ago, as it may not have passed our stringent downside protection criteria. At higher prices, the shares most likely did not offer the "margin of safety" they provide today. The price decline over the past year has *lowered* investment risk rather than increased it.

Are you saying that the stock price will not decline from this point forward?

No. While we expect the stock to exhibit below-average downside volatility, almost anything is possible in the stock market in the short term. As a result, you should never lever up to buy a stock, even if we judge it to have "superior downside protection." We use the latter term to refer primarily to the risk that your capital will be *permanently* impaired if you invest it in our top pick. While our analysis gives us high conviction that you will not suffer permanent loss, we cannot guarantee that our judgment will always be correct.

What criteria do you use to determine that a stock has "superior downside protection"?

First and foremost, we want the stock to trade at a large discount to our appraisal of fair value. Such appraisal can be based either on the value of the company's assets, including cash, accounts receivable and real estate, or on the present value of estimated future cash flows, or both. Each situation is different—how we arrive at an estimate of fair value will reflect the peculiarities of the particular situation. Once we estimate fair value, we ask a number of questions that help us build conviction that current value will be safeguarded and, in fact, increased over time. For example, we want management that is capable, properly incentivized and likely to treat fellow shareholders fairly. We also favor companies that have authorized a plan to repurchase their own shares when they are available at a discount to fair value. Repurchases not only provide short-term support for the stock price but, more importantly, boost per-share intrinsic value and signal management's willingness to return cash to shareholders. Finally, we want companies with strong and liquid balance sheets, enabling their executives to steer through—and take advantage of—difficult economic conditions.

You include some stock screens in this report. Are you saying that the companies passing those screens are also good investment opportunities?

Not necessarily. We provide three downside protection stock screens in order to identify companies that *may* represent good investments. We provide the screen results as a starting point from which you may choose to do more work on specific companies. As a subscriber, you may also ask us to research one company for you each year. Email us at editor@manualofideas.com.

Do you expect to include other information in this report going forward?

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