July 25, 2018

Dear Partners and Friends,

The return of Maran Partners Fund in 2Q 2018 was +5.6%, net of all fees and expenses. Year to date, the fund is up +3.3% net.

While my concentrated approach means that returns will be lumpy, I am encouraged by the fact that, in general, our holdings trade at large discounts to intrinsic value, and their values continue to grow. I remain committed to first and foremost protecting, and then growing our capital in a world where many seem to be taking larger and larger risks. We own a portfolio of what I think are truly compelling, under-valued, off-the-beaten-path companies in a market that as a whole does not seem particularly cheap.

Network Effects

While independence of thought is paramount in this endeavor, the ability to both source and vet ideas with fellow portfolio managers, business owners, and entrepreneurs is incredibly useful. My network of smart fellow value investors is truly invaluable. I have served as an instructor at recent Manual of Ideas conferences for this reason, contribute to the Value Investors Club community, and have helped organize and host a quarterly idea dinner (in New York City and, more recently, Denver) for over a decade.

Our wonderful group of limited partners further expands and strengthens our ecosystem. We all have skin in the game in our current portfolio of ideas, and among us are experts in areas ranging from real estate to packaging to consumer goods to basic materials.

It is against this backdrop that I traveled to Vail in late June to participate in VALUEx Vail (a conference for self-described "die-hard" value investors) for the third time. At VALUEx Vail, 40 value investors come together to discuss ideas for three days. This year, roughly 30 ideas were formally presented, but the conversations on the sidelines meant even more topics, themes, and ideas were discussed. What better way to learn a company than to have an expert explain the ins and outs of it to you while on a two hour hike to the top of a mountain?

This year, I presented Clarus (parent company to Black Diamond Equipment and Sierra Bullets) in a five-minute "dessert talk" (the shorter of two formats the conference uses for presentations). I have spent a lot of time thinking about the long-term potential of Clarus, and recently wrote a new, detailed investment memo on the company. My thoughts distill down to the following:

15 + 5 + 5 + 3 + 7 = $35

- I think the current fair value of Clarus is $15/sh;
- Black Diamond ("BD") could build an apparel business worth an incremental $5/sh over the next five years;
- BD could build a footwear business worth an incremental $5/sh over the next five years;
- Sierra could grow mid-cycle EBITDA from ~$12mm to ~$20mm over the next five years, creating an incremental $3/sh in value;
- FCF generation and capital allocation could create an additional $7/sh in value over the next five years.

Clarus is trading for $8/sh and change, and I think there is a path to $35/sh over the next five years. If I'm wrong on some elements of the thesis, I still think we will preserve and indeed compound capital in this position, though perhaps at a rate lower than the mid-30%s. I think there is limited risk of permanent capital loss due to its cheap valuation, its strong, growing brand, the excellent secular backdrop, a clean balance sheet, an aligned management team, and recent share buybacks/Dutch Tenders. (Of course, all investments entail risk; please see important disclosures on page six.)

Earlier this week, I spent two days at the Outdoor Retailer trade show. I met with Clarus' CEO, CFO, chairman, several key designers (from both the apparel and footwear categories), as well as the global head of sales and other leaders in the sales and marketing organization. I also met with numerous competitors, suppliers, and customers (retailers/distributors).

While vigilant not to let increased knowledge and depth of research lead to over-confidence, I was encouraged by my findings and maintain high conviction in this position.

Special Situations – Biglari Holdings Revisited

I refer to the concept frequently, but admittedly *special situations* is a bit of a nebulous categorization. It encompasses a large swath of investment strategies and opportunities. The critical element is that the *situation* in question might cause a mispricing of a security. It doesn't always imply a catalyst, but frequently, if there is an identifiable reason that something is mispriced, eventually people will come to notice it.

A handful of special situations that may create mispricing include spin-offs, post-bankruptcy, rights offerings, broken deals, broken IPOs, SPACs and broken SPACS, etc. It is difficult to include all of the special situations that may arise in a simple list. Some may be unique, driven by a specific regulatory or contractual circumstance. One thing they tend to have in common is a vacuum of information and therefore a requirement that investors do their own work. This suits me.

Consider this recent special situation: a corporate transaction that led to the creation of a dual-class share structure (announced via SEC forms 425 and DEFM14A – not a press release – and voted on at a special shareholders meeting), which led to the removal of said company from the S&P600 and similar indices (the S&P indices don't like companies with dual class structures, apparently), and thus the *forced selling* in two days of what would normally be 20 days' worth of trading volume (over 10% of the float).

In this instance, there was no change in control – the chairman and CEO controlled over 50% of the vote before the creation of the dual class structure, and he controlled it after. The economic value of the company didn't change over the two-day period. But the stock dropped following this announcement by – drumroll please – over 35%.

The sellers (index fund managers like Vanguard and Blackrock) were effectively forced sellers. They blindly follow the dictates of the S&P composition committee. I love buying from forced or otherwise uneconomic sellers.

In this instance, I happened to know the company, Biglari Holdings (BH), very well. Indeed, I attended the shareholder meeting at which the aforementioned vote occurred. I had trimmed the position meaningfully leading up to the meeting. Given this, and that I had done the work over the years to fully understand the business (which indeed has its quirks) and its valuation, I was in a position to be decisive during the sell-off. In the days and weeks following the vote and index exclusion event, I increased our position yet again.

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Portfolio Update

At the end of the quarter, the partnership was 97% long by 1% short. Our top five positions were Clarus Corp (CLAR), Biglari Holdings (BH), Turning Point Brands (TPB), Scheid Vineyards (SVIN), and Atento (ATTO). Our top ten longs accounted for 89% of our long exposure.

Clarus Corp (CLAR)

Discussed above. Additionally, over the course of the past few months, Clarus was engaged in a Dutch Tender for its own shares. They repurchased 417k shares (1.4% of the shares outstanding; 1.9% of the float) at a price of $8/sh. They also announced that they expect to initiate a dividend this quarter, which will yield slightly over 1%. I'm happy to own a large position in this company at prices at which its chairman (and 25%+ owner) sees good value in the shares.

Biglari Holdings (BH)

Discussed above. Following what I believe was the technically driven sell-off, BH's chairman, Sardar Biglari personally purchased several million dollars' worth of BH shares. You can see a theme here: we own shares in a number of companies in which insiders have significant skin in the game, and in which they are increasing their ownership of said companies at current market prices.

Scheid Vineyards (SVIN)

In June, Scheid Vineyards released their annual report and, for the first time in over a decade, a detailed shareholder letter. They continue to come out of the "dark" and improve shareholder communications.

The letter, from Al Scheid (Chairman) and Scott Scheid (CEO), is well worth a read for those interested in the business. They discussed their strategy of foregoing the maximization of current earnings to further increase the long-term intrinsic value of the business. They have retained some inventory that they should be able to sell at higher prices in the future (either via a tightening bulk wine market or, better yet, via their growing branded cased-goods business). They are also investing in people, infrastructure, and marketing to support the branded business (reducing current earnings power to drive future intrinsic value growth). As I have previously discussed, the shift to branded business should drive revenue, margins, and the multiple at which the business should ultimately trade. They are making sensible decisions and are running the business like true owners, which they are.

Two other things to note from the shareholder letter. The company successfully completed the annexation and rezoning of approximately 130 acres into the town of Greenfield, CA (something on which they have been working for years). They will likely sell this land to developers of residential and commercial properties. This source of previously "hidden" value is in the process of becoming unlocked (I value this land at approximately $10/sh in my base case). Finally, Scheid released updated appraisal values of their land and winery. This update supports a current liquidation value of $200 - $225/sh for the company (100 – 135% upside), before considering additional value uplift from the growth of their branded cased-goods business (which could ultimately be worth several hundred million dollars, against the current market cap of $85mm).

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My concentrated, patient approach means companies in our top five holdings turn over infrequently. Thus, smaller holdings generally get less air time in these letters, despite the fact that I still think they are very compelling (and thus warrant a place in our portfolio).

Spark Networks (LOV)

Spark Networks is a leader in the global online dating market, going to market under brands including eDarling (Germany, France, Spain, Netherlands, Russia, Poland), EliteSingles (UK, Australia, Canada), JDate (the leading Jewish dating platform globally), and Christian Mingle (the leading Christian dating platform in the US). The company was formed via the reverse-merger of privately-held Affinitas GmbH into the US-listed Spark Networks. Effectively, Affinitas bought Spark Networks and used Spark's listing to go public in the US (as an ADR).

Sentiment is rock bottom for Spark. When investors hear the name, they think of "old" Spark, a sub-scale, sub-$30mm revenue, money-losing, underinvested, shrinking business. "New" Spark, though, is a $130mm+ revenue, well-run, growing, profitable, subscription-based business with high insider alignment.

Affinitas (and thus "new" Spark) has been executing a "buy and build" strategy in the online dating space for the last decade. They have grown their Revenue from EU21mm in 2010 to EU86mm in 2017, and expect sales to top EU100mm this year. Affinitas has a history of buying companies for 3-5x EBITDA (after realized synergies). The industry continues to consolidate.

Spark's market cap is ~$150mm, and $10mm of net debt brings their EV to ~$160mm. They are guiding to $13-18mm of EBITDA this year, putting the trading multiple on that headline number at around 10x EBITDA. But the company is "investing" $6mm worth of EBITDA deficit this year to launch and grow a new brand, Silver Singles. Absent this growth initiative, EBITDA might have been $22mm this year, putting the multiple at 7.3x.

Match.com, the clear industry leader in online dating, also happens to trade at 7.3x, but on a slightly different metric. Yes, Match.com trades at 7.3x sales. On this metric, Spark trades at 1.2x, an 84% discount.

Over the next few years, I think Spark can grow FCF to over $2/sh (from the current FCF generation power of ~$1/sh), and should be valued at $20-30+ per share. Value on a per-subscriber basis based on comparable transactions also yields targets in the mid-high $20s/sh.

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Summer Reading

As someone whose job contains commonalities with that of an investigative journalist, I have enjoyed a number of books that pit an intrepid, deep-researching *David* against an imposing, deep-pocketed, but ultimately wrong (or indeed, evil) *Goliath*.

David Einhorn's *Fooling Some of the People All of the Time* was excellent, as was *Chain of Title* by David Dayen, each of which fit this mold. *The Emperor of Scent* by Chandler Burr is a fun, quick read about a maverick scientist who went up against the establishment to propound his scientific theory of scent. And while also on a topic far from companies and investing, *Shadow Divers* by Robert Kurson demonstrates the level of research that amateur, hobbyist, but deeply curious people can attain about a topic of interest. (Indeed, *interest* and *curiosity* are paramount in learning deeply about just about anything.)

John Carreyrou's *Bad Blood* aptly adds to this genre. It recounts the saga of Theranos, the sham blood testing start-up once valued at $9bn. His dogged reporting helped uncover the fraud, and serves as an inspiration for the depth of research that can be done on (even private) companies. Readers are also exposed to the full range of behavioral biases in action, from the *sunk cost fallacy*, to the *fear of missing out*, to pure *psychological denial*. That said, the profound lessons of this book are embedded in a page-turner. As serious as the topic is, *Bad Blood* is a great summer-vacation beach read.

Conclusion

In a recent correspondence with Al Scheid, Scheid Vineyards' chairman, he wrote:

> FYI, the first harvest was 43 years ago - the first planting was 46 years ago - March, 1972. The first two years - sometimes three - there is no fruit or not enough to make picking worthwhile. So, it is the third "leaf" that some picking is generally done (we say leaf instead of year because that first possible harvest is actually about 30 months after planting). With good weather the first crop of vigorous varieties can be a ton per acre - that's what we hope for…

As in grape-farming and wine-making, investing in most business ventures requires patience. The trope is that there is frequently a decade of hard work behind every overnight success.

Slightly more than three years ago, I started planting the seeds for Maran Capital. I had moved back to my hometown of Denver after over a decade in New York City, my older daughter (the "an" in Maran) having turned three, and my younger daughter (the "Mar") less than one month old. The seeds have grown and are starting to bear fruit. Thank you for being a part of this journey thus far. I look forward to continuing to protect and grow our capital.

Sincerely,

Dan Roller

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In Q2 2018, the total return of the S&P 500 was 3.4%, and the total return of the Russell 2000 was 7.8%. YTD, the total return of the S&P500 was 2.7%, and the total return of the Russell 2000 was 7.7%. The S&P 500 and Russell 2000 are indices of US equities. They are included for information purposes only and may not be representative of the type of investments made by the fund. The fund's investments differ materially from these indices. The fund is concentrated in a small number of positions while the indices are diversified. The fund return data provided is unaudited and subject to revision.

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