

October 22, 2018

Dear Partners and Friends,

I remain focused on preserving and growing our capital, and continue to believe that the best way to do so is via a value-driven, concentrated, patient approach. I shun consensus holdings, rich valuations, and market fads, in favor of solid, yet frequently off-the-beaten-path, businesses run by excellent, aligned management teams, purchased at deep discounts to intrinsic value.

Of course, such an approach will be more volatile than broader market indices. While some may jump to the conclusion that our portfolio is riskier than the market solely because it is more concentrated, I believe that line of reasoning to be erroneous. I believe our concentrated portfolio of high quality, largely undiscovered companies, run in many cases by owner-operators, is in fact significantly less risky than the overall market. I reiterate: I don't believe that volatility is equivalent to risk.

After the first half of 2018 in which we "managed boredom," I'm pleased to report that Maran Partners Fund returned +13.6% in 3Q 2018, net of fees and expenses. This brings the YTD return to +17.4% net. For the majority of limited partners, who have elected our three or five-year lock-up share classes with reduced fees, returns were better. Please check your account statements for the details.

Despite the recent sell-off from all-time highs in the major indices, I believe the market as a whole remains expensive. That said, dispersion has been wide; there have been major dislocations in individual stocks, sectors, and countries.

I am finding more deeply undervalued quality businesses right now than I have in years.

This, coupled with the recent pull-back in several of our existing core positions, leaves me excited about our opportunity in the coming quarters and years.

Of course, in all market environments, I am guided by core values.

I continue to:

- underwrite our investments with deep, independent, fundamental research;
- maintain an ownership mentality with respect to investing;
- seek out high quality companies run by wonderful management teams with aligned interests;
- remain extremely disciplined with respect to valuation;
- concentrate the portfolio in my best ideas;
- invest with a long time horizon (and thus treat volatility in quoted prices as an opportunity); and
- maintain aligned interests with my partners.

## Hunting for Value in an Expensive Market

When I'm with my in-laws, or when I see my parents on the weekends, they frequently ask me what the market is doing. I almost always respond that I don't know. Now sure, I have a general sense of where it is, and what broad measures of valuation are. But on any given day or week, I generally don't know whether *the market* is up, down, or sideways.

When I launched the fund in the summer of 2015, I wrote, "I am cognizant of the fact that we are in the 7<sup>th</sup> year of a rising stock market and close to all-time highs in the broader indices. Many stocks appear over-valued. Some markets and sectors are in bubble territory." Here we are three-plus years later, and with a quick copy-replace of 7 with 10, the paragraph would still ring true.

During the third quarter, I had the chance to listen to Howard Marks, chairman of Oaktree Capital, speak about his most recent book, *Mastering the Market Cycle*. In addition to sharing his wisdom on a wide range of topics, he said that he thinks we are in the eighth inning of the current cycle (although he hedged a bit: "you never know how many innings there are in the game"). He noted the following signs are present: high optimism, greed, jealousy over the investment gains of your peers/friends, among other signs of generally positive investor psychology.

I don't disagree with Marks, but importantly, we aren't forced to own the whole market. Our fund is invested in a very small subset of companies in the market for stocks, and not in the "stock market" as defined by any broad index. Each sector and indeed each stock may have its own cycle. Some stocks and sectors are completely out of favor right now, even as the cycle as a whole may be closer to the peak.

For example, while the *market*, at least as defined by the S&P 500, is only off its all-time highs by about 5%, the following ETFs are at their 52 week lows: Basic Materials; Autos; Timber/Lumber; Homebuilders/Building Products; China; Hong Kong; and Europe (as a whole, as well as each of the following individual countries: Italy, Spain, Germany, Sweden, France, Belgium, UK, and Ireland).

The S&P 500 would have to fall about 9% to join the above list of ETFs at 52-week lows (imagine the panic; people seem concerned enough about the current decline already).

I believe that by focusing on our off-the-beaten-path hunting ground, and selecting a small handful of companies from the bottom up that we would like to own, allows me to mostly ignore what the entire market is doing, and should allow me to protect and compound capital while limiting the fund's correlation to the broader market. Since inception, despite our meaningful net long exposure, our correlation to the S&P 500 has been just 0.39.

## Patience

We are patient investors with a long time horizon, as I believe this is one element of an approach that should yield superior returns over time.

Patience manifests itself in various ways. I have written before about having extreme patience coupled with extreme decisiveness: basically, the will to wait until a very compelling opportunity arises, and then the conviction (backed by research and reasoning) to make it count.

Once in a position, patience allows me to comfortably own and hold stocks that may be out of favor or otherwise not working (as long as they meet a myriad of criteria for inclusion in the portfolio, which I have

discussed at length elsewhere). I don't try to predict the short-term moves of the market nor our portfolio; it frequently takes time for the market to correct inefficiencies in individual stocks.

These manifestations of patience are fairly straightforward. But a subtle and less-discussed element of a patient approach is the ability to own and hold stocks that *are working*.

When a stock is up 30%, 50%, or even 100%+ (especially in a reasonably short period of time), there may be a tendency for some portfolio managers to look to sell, or at least trim, the position. After all, they may think, why not lock in the gain. Of course, meaningful appreciation is a good reason to reevaluate a position, but not a good reason, in and of itself, to sell a position.

When you have a good business run by a good management team (especially good capital allocators), patience can be one's friend. If value is compounding at a high rate, a stock can be up a lot but still be cheap! With a good business run by good capital allocators, surprises are frequently to the upside (I love being surprised by a company doing a good deal, or in buying back their own cheap shares).

Our largest position, Clarus, performed well over the summer, on the heels of positive operating momentum coupled with a Dutch Tender by the company to, essentially, repurchase every share they could get their hands on at \$8. Yet despite the recent appreciation (and the fact that the stock has doubled over the last three or so years), I am sitting on my hands. In this case, I still think it is a "three year double" from recent prices. If things continue to go well, perhaps in three years it will be a \$20+ stock, with a pathway to \$40 over the ensuing three years. If I'm close to right, continued patience, even in the face of future volatility, will be a virtue.

### **Portfolio Update**

As of the end of the third quarter, our top five positions were Clarus Corp (CLAR), Biglari Holdings (BH), Atento (ATTO), Scheid Vineyards (SVIN), and Turning Point Brands (TPB). The top ten long positions accounted for 88% of our long exposure, and the fund was 98% long by 5% short, bringing net exposure to 93%.

The portfolio remains a blend of what I believe are long-term compounders and special situations, which generally have a shorter-term catalyst. Of course, these aren't always mutually exclusive – a *special situation* event can lead to a disruption that creates an attractive entry price into what is otherwise a quality, well-run company that can be a long-term, core holding. I believe that all of our positions, regardless of categorization, have a significant margin of safety and a large reward/risk skew.

While our top five positions are unchanged since last quarter, expect some changes in the year-end update. I am patient where warranted, but also want to ensure the portfolio is best positioned given the opportunity set at all times.

### **New Positions and Special Situations**

I purchased and have been adding to two smaller companies that I believe are very cheap. I would be happy to buy each business outright at the current quoted prices. I don't believe that it would benefit the partnership for me to share the identities of these companies right now, as I am still in the market adding to the positions.

One is a business services company with a net-cash balance sheet, copious free cash flow generation, and very limited capital reinvestment needs. Insiders own a meaningful amount of the company, but are not entrenched; I believe interests are well-aligned (of course, skin in the game is a frequently important but not sufficient condition for alignment of interests). The company has an active buyback in place. I attribute the opportunity the company's small size, relative illiquidity, and lack of coverage.

During the quarter, the fund participated in a special situation in which a company exercised their contractual right to purchase one of their securities at a predetermined price (calculated by a formula). Because the price at which the contractual right was offered was well below intrinsic value (this was effectively a take-under), and the stock was trading below the calculated offer price, I felt comfortable participating in this arbitrage. There is a similar situation that I am following right now in which a company will have a contractual obligation (not just a contractual right) to bid for a security, setting up an interesting short-term risk-reward situation.

### **Conclusion**

Someone recently drew my attention to a Twitter post that read, "Today was the worst decline since the February decline you don't remember anymore." Indeed, it is difficult to recall that in early 2018 the S&P 500 fell ~10% peak to trough over a few weeks, or what the principle concerns were at the time.

Market volatility has picked up again over the past few weeks. Headlines highlight risks regarding interest rates, the Fed, China, house prices, auto sales, trade wars, and more. Uncertainty abounds. But doesn't it always? I have no view on whether the recent volatility will continue for a while, or whether the market will be back at all-time highs before we know it.

But I do have a very firm view on the fundamentals of our idiosyncratic portfolio. I like what we own, and I like some of the opportunities that the recent market volatility has created (in stocks that are down more than 5% from all-time highs). I believe we are well-positioned to protect and grow our capital over the coming years.

I look forward to updating you again in January. In the interim, please don't hesitate to reach out if you have any questions.

Thank you for your continued trust and support.

Sincerely,



Dan Roller

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Prior to investing, investors are strongly urged to review carefully the Offering Memorandum and related documents, including the risks described therein associated with investing in the Fund, to ask additional questions and discuss any prospective investment with their own advisers. Additional information will be provided upon request.

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In Q3 2018, the total return of the S&P 500 was 7.7%, and the total return of the Russell 2000 was 3.6%. YTD, the total return of the S&P500 was 10.6%, and the total return of the Russell 2000 was 11.5%. 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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