GREENHAVEN ROAD
PARTNERS FUND

May 2019

Dear Limited Partners,

The Partners Fund returned approximately +8% in the first quarter. This was below the major U.S. indices. Why? We have one fund that is entirely invested in Europe; another is over 35% invested in Korean equities. We now also have some South African exposure (Desert Lion discussed below). Over time, we should see a divergence from U.S. indices because of the nature of the underlying holdings. We have not recreated the S&P 500 – our portfolio is intentionally different.

SEEDING ANNOUNCEMENT – Introducing Desert Lion

In the last two letters, I discussed the likelihood that we would seed an investment manager. There are many forms of seed investing. The core of most seed relationships is a sizable limited partner (LP) investment into a fund in exchange for a portion of the economics of the overall fund. To put it another way, in addition to whatever returns one would earn as an LP, a seed investor will also get a portion of the profits that the manager earns from management and incentive fees of the entire fund. If a fund is seeded at launch, there may be no other limited partners yet, in which case owning a portion of the overall fund would have no impact on returns. However, if the fund attracts other investors, the revenue share contributions can become quite substantial.

In the movie "The Graduate," Dustin Hoffman's character is in the process of graduating from college and trying to find his way in the world. In one scene, one of his father's successful friends tries to give him advice and boils the key to financial success down to "one word – plastics." We all know that life is not that simple, but if I only wanted my daughters to be as wealthy as possible, my one word for them would be "GP" (General Partner). If structured properly, owning a small piece of a general partnership can be very asymmetric with the rewards substantially outweighing the risks.

I have been through the seeding process once before, as Greenhaven Road was seeded by the Royce Family and Stride Capital Group. I made the seed deal because I thought I could get further with their support and guidance as partners than I would continuing on my own. Owning most of something larger was better than owning all of something smaller and not functioning as well. If you have the right partners, the proverbial "win/win" *is* possible.

Despite my belief that seeding arrangements can be wildly asymmetric and positive for all parties involved, I was not actively looking to go down this path. So what happened? Because I make the letters for Greenhaven Road's main fund widely available and many managers are aware of the Partners Fund, I receive a lot of quarterly letters and I read them all. One day last spring, I got a batch of letters from South African manager Rudi van Niekerk, who manages an entity called Guscora. I was really impressed with the letters, the way Rudi analyzed businesses, and his investment approach. I felt like I was reading letters that I would have written if I were investing in South Africa. I forwarded them to one of our LPs who lives in South Africa, and he ended up investing in Guscora. When he forwarded the fund's presentation, I felt like I could have written that as well.

One of the many benefits of working out of the Royce Family Office is the proximity to Chuck Royce. It is easy to collaborate and poke at ideas together. Rudi's philosophy and the valuations of the underlying companies piqued my curiosity, so I asked Chuck to join me on FaceTime with Rudi because I knew he would enjoy hearing about South African companies and the journey of a fellow investor. A first FaceTime led to a second, which led to a third…

What did we learn? Rudi was investing in off-the-beaten-path companies outside of the FTSE/JSE Top40, pursuing a concentrated, low-turnover strategy and accepting short-term volatility in exchange for long-term returns. Between his current investment vehicle, Guscora, and its predecessor, Rudi had significantly outperformed his market. I also found his personal history compelling – growing up in a small agricultural town in South Africa, beginning work as a grain trader, migrating to private equity, and eventually moving to public equity markets to manage an investment partnership that was almost exclusively friends' and family money. He really fit all of the criteria of the Partners Fund. He is a one-person investment committee, managing a reasonable amount of capital with significant personal investments, original thinking, and a mindset where getting rich is not the point.

There are thousands and thousands of funds in the U.S. One does not have to venture to South Africa to meet our criteria. Yes, South Africa has great natural resources and a strong rule of law, but it also has a neglected power infrastructure resulting in frequent blackouts, unemployment in excess of 30%, a failing public educational system, and government corruption. In addition to all of these domestic issues, South Africa also has a volatile currency. One of the most liquid global currencies, the Rand (ZAR) is often used as a proxy for other emerging market currencies and can sell off for non-fundamental reasons such as instability in Turkey. So far, being "underweight" South Africa sounds perfect.

Would I want to own a South African index fund for the next ten years? No. Fortunately, Rudi is not an index fund, he is a stock picker. The South African market consists of about 385 stocks, and the Top 40 make up around 78% of the JSE total market capitalization. These 40 are well-covered by analysts and mutual funds. When we get outside of the Top 40, it starts to get pretty interesting. Out of more than 1,250 South African mutual funds, only 10 are registered with a concentration on small- and mid-cap companies, leaving that area of the market far less picked over. There has also been a prolonged pullback in the country's equity markets. Adjusted for inflation, more than 60% of stocks are trading at prices lower than they were five years ago. The valuations that are available in South Africa are just not seen in the U.S.: real companies selling for PE ratios of 3x to 6x. The country is not without its problems, but it is a very interesting environment for picking stocks.

So, we had a very interesting manager focused on a country with a less competitive fund landscape, and valuations that are a distant memory in the U.S. Why not back up the truck? We are unlikely to ever "back up the truck" for small caps in emerging markets, and South Africa has some political considerations that should give one pause. But where we really got stuck was the structure of Rudi's vehicle Guscora, which is highly favorable for local (South African, etc.) investors, but has more complexity and no benefit to U.S. investors. At the end of one of our phone calls, Chuck said, "Everybody is underweight Africa. Let's help him set something up that we can understand and feel comfortable investing real money in. If nothing else, we solve the problem for ourselves, but this will likely work for others as well. Rudi could be the real deal. Let's remove the barrier."

Over the next several months, this led to the creation of Desert Lion Capital, which launched on April 1, 2019 and is now open to outside investors. Interested readers can visit Desert Lion's website (https://www.desertlioncapital.com/access) and enter your contact information to be added to the quarterly distribution list and access the launch letter. You are also welcome to email InvestorRelations@desertlioncapital.com for further information.

There are three parties to the seed arrangement: my family, the Partners Fund, and the Royce Family. The arrangement is structured such that the Partners Fund gets favorable terms on our LP investment and will receive a percentage of the management fee and incentive fees earned by the fund if and when other investors show up. If South Africa were not an interesting market and Rudi were not an interesting manager, we would not have gone through all of this effort. The Partners Fund will have capital at risk (sub-10% position), but that is it. The Partners Fund will not be responsible for the set-up expenses or any operating losses at the general partner level, but will benefit if Desert Lion is successful with performance, asset raising, or both. There are risks any time one invests in a small cap emerging market manager, but given the already depressed valuations, less competitive market, Rudi's track record, and the terms under which our money is invested… let's just say I like the set-up.

GOING FORWARD

So now that I have hopefully established my belief in the financial opportunity that can come from being a seed investor in a fund, let me be clear: seeding will not become the focus of the Partners Fund. This was opportunistic and was possible because of our relationship with Stride Capital Group, who are professional seeders. Stride helped us structure this deal as another part of their commitment to our holistic success. That said, their business is seeding funds, not helping their seeds seed other funds, and we do not expect to add another.

In the short term, seed economics will not add materially to returns. For early investors, Desert Lion is offering a 0% management fee Founders Class, so there will be no such revenue to share for the time being. Incentive fees are only "crystalized" at year-end, so we are guaranteed a payment (which we can redeem or leave invested in the fund) only if fund performance exceeds the hurdle rate. In the long term if Rudi is able to capitalize on the opportunity, we will share in his success. I believe that the seeds for our future returns have been planted.

FINAL THOUGHTS

As I have said at the end of every letter... our fund of funds is going to be different. It will be smaller, the underlying holdings will be more esoteric, and I hope the managers will collaborate more over time. I believe that it will all be good different, but only time will tell. Thank you for joining me on this journey. I will work hard to grow your family capital alongside mine.

Sincerely,

Scott Miller

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