



November 2019

Dear Limited Partners,

Imagine this scene. In the hallowed halls of the Harvard Club in New York City, a professional money manager gets up in front of a room full of investors and utters the words, “I am an underperformer.” What is the appropriate audience reaction? Shock? Condemnation? Removal from the premises? I will argue that that simple sentence does not offer enough context to decide.

The first question I would like answered is – what time frame are we looking at? In his book *The Big Secret for the Small Investor*, Joel Greenblatt of Gotham Asset Management discusses a study of money managers for the decade from 2000 until 2010. For the managers with top quartile performance over this ten-year period, 97% spent at least three years in the bottom half of performance. Perhaps more surprising, 47% of the top overall quartile spent at least three years in the bottom decile. This is to say that many of those with the best long-term investment records spent multiple years decidedly at the bottom of any performance chart while on their journey to outperforming their peers.

For those of you who were not in attendance, the above scene played itself out at our Annual Meeting last month. The manager in question is Steven Wood of GreenWood Investors. I have known Steven for several years. He was the first investor I knew to articulate a long thesis on Fiat that I could understand. He does very deep work and is a flexible thinker. I read everything Steven writes that I can get my hands on.

About two years ago, Steven approached the Partner’s Fund with an SPV (Special Purpose Vehicle) idea. He had invested 20% of his main fund in a European company and had an activist agenda. He believed that over time, with his envisioned changes, there was a clear path to making multiples of our initial investment. Steven wanted to own more of the company in order to maximize the potential financial returns, but more importantly, owning a larger percentage of shares can be helpful in gaining influence to advocate for desired changes. For risk management purposes, Steven did not want to put his entire fund into the company. Thus, he set up a separate vehicle with a very fair fee structure to invest exclusively in this target company. The Partners Fund invested in this “underperforming” SPV.

So, is Steven an underperformer? The price chart for the target company has not been pretty. At the time Steven was speaking during our meeting, the share price was down approximately 20% for the year. It is hard to argue quantitatively with Steven’s statement about performance. However, the original investment thesis was not predicated on steady monthly returns; rather, it was a multi-year bet on the transformation of a company.

At the time of the investment, Steven’s “playbook” to improve the business had multiple components. For confidentiality reasons (since Steven has not revealed the name publicly), I will not go into all of the facets, but from a financial perspective, with some fairly modest assumptions, the model’s base case return was greater than 100% with plausible scenarios leading to returns of between 5X and 10X our capital over five years. If Steven was close to correct and able to see any of his proposed changes implemented, we agreed that this bad business could be a very good investment.



Steven's plans for the company were clearly ambitious and very different than anything publicly articulated by management at the time of investment. His playbook called for structural changes to the business and capital allocation that would require both management and board support. Based simply on his LinkedIn profile, I would not back Steven. He did not go to Harvard Business School with the right European elites, and he is a native of Louisiana, not London or Lisbon. In any scenario, the SPV would be a minority shareholder, and executing his playbook would rely on persuasion and building relationships.

Fortunately, during our mutual investment in Fiat Chrysler (FCAU), I had seen Steven gain a level of influence that I thought impossible for a fund of his size. He was nowhere near a top 500 shareholder so it would have been reasonable to expect him to have no contact at all with management, yet he had built strong personal relationships with both the CEO and Chairman of the Board, leapfrogging hundreds of investors based solely on the quality of his ideas and his interpersonal skills. Multibillion-dollar funds would go to Steven for insights as well as to attempt to have their views heard by management. Steven is world class at building relationships and influencing outcomes in a very authentic manner. The playbook for the SPV is clearly ambitious, but Steven, in my opinion, has a real chance at success. Inspired by the Fiat run, Steven has told us we can expect to own "multiple pieces of paper" at the end of our journey.

What has Steven accomplished with his activism so far in Europe? In less than two years, Steven has secured a board seat, built strong relationships with major shareholders, and recently was instrumental in recruiting a new CEO and other key top executives. During his involvement, the company has made an acquisition to accelerate profitability and is undergoing a restructuring. Profitability has improved, the company has indicated it will begin selling non-core real estate, and they have announced an important new contract that was also part of the playbook. Just about every facet of Steven's original plan is in progress.

Has Steven really underperformed? In my opinion, the only metric of underperformance so far has been share price. While most activists write letters and issue press releases, Steven has gained influence very quietly, fundamentally improving the company and its direction. Change takes time to implement, and it takes even longer to see those changes hit the income statement, and sometimes even longer for the changes to be reflected in the stock price. There have been several windows where we could have redeemed our investment during the year and a half since we first invested, but we remained committed to Steven's activist vision as he continued working to unlock company value. The SPV performed very well in September and particularly well in October, even without much of Steven's playbook announced. We hope the market will continue gaining appreciation for the company's new trajectory. In my book, Steven was never an underperformer.

There is also a larger question of underperformance for the Partners Fund. As you will see from your statements, we have not had outperformance yet either. I think there are several potential explanations. Maybe I am bad at selecting managers. Maybe we just have a disproportionate number of managers who simultaneously are having years in the bottom half or bottom decile of performance on their way to overall outperformance. Greenhaven Road's main fund underperformed on a relative and absolute basis during its first two years before rebounding on a path to attractive returns. The strategy of investing with smaller managers who use a concentrated approach, have significant skin in the game, and are original thinkers still resonates with me. It certainly can work; we will see over time if it does.



On the evening of the annual meeting, I was continually struck by the asymmetry of the ideas presented, as well as their diversity. The managers presented a South African education company, a monopolistic small cap communications company, a pharmaceutical manufacturer, an outdoors-related conglomerate led by a CEO who grew his previous company 100X, a software company focused on airport management, an industrial roll-up, an education software company, an Amazon competitor, and the European SPV target company. I was very proud of the talent in the room. I think it is just a matter of time before it starts showing up in the quarterly statements.

All limited partners should have received an email from Ally (investorrelations@greenhavenroad.com) with a link to the audio from the meeting. Please let her know if you need it re-sent over the next few weeks, as the link is only available until Monday, December 2nd.

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 continue to 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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