



May 2020

Dear Limited Partners,

The first quarter marked the arrival of the pandemic and the fastest bear market in modern financial history. In this period of high volatility, individual funds' performance was largely a function of positioning entering the pandemic (exposures to travel, restaurants, etc.), net market exposure, and possession of "black swan" insurance. As our managers have a long bias and are geared towards the more esoteric, underlying performance ranged from +3% for an SPV to -44% as the largest fund loss. Overall, the Partners Fund returned -23.5% in Q1. Unsurprisingly, given the rebound in the overall equity markets, many of our managers have had strong starts to the second quarter. For example, the manager that fell the furthest during Q1 returned +35% net in April. As the world and the markets continue to grapple with the medium- and longer-term impacts of COVID-19, our underlying managers are firing on all cylinders with highly aligned interests in pursuit of capital recovery and long-term success.

This is the first time any of us have lived through or managed money through a pandemic. This unique situation introduced a witch's brew of new variables such as viral spread rates, economic impacts from sheltering in place, and an unprecedented level of government stimulus programs. There is a credible case for inflation, and there is a credible case for deflation. What shape will the recovery take? Will there be a second wave of closures?

We have seen oil prices go negative for the first time in history, and the amount of negative-yielding debt is only increasing. There are multiple feedback loops, and when one's assumptions about the virus, the recovery, or the effectiveness of government programs change, there are typically implications for portfolio construction as well. There are many more variables interacting in new and different ways that one must consider when managing a portfolio today vs. in "normal" times.

Given this changing and unusual investment landscape, I want to expose you to several of the underlying managers and their approaches to managing through the pandemic in this letter. Since these managers are each prone to writing their own 10-page letter in a normal quarter, it's likely that they each could write a book on the current environment. In the interest of space and preserving their time for investing, I asked several of them for a very brief summary of their present worldview, plus a current idea. You should assume that there is far more nuance to each manager's approach that cannot be covered in the confines of a few sentences. You also should assume that these managers are opportunistic and are prone to change their minds very quickly as facts change and opportunities present themselves. (Commentary has been provided in mid-May, so views have evolved from quarter-end.)

Our managers each have had a unique response to the present environment, and thus they are all finding value in different forms, ranging from companies that may actually benefit from the current environment, to companies that are far too cheap after being thrown out with the bathwater, to special situations that present opportunity independent of the current environment. Regardless of what form their investments take, it is clear that the pandemic and the volatility have created opportunities for stock pickers.



## **LAUGHING WATER CAPITAL – MATTHEW SWEENEY**

We are living in a very strange time; it seems clear that the real economy will face serious challenges for an extended period, yet the stock market seems to have already put these challenges in the rear-view mirror. It is impossible to know with any certainty if the stock market is correctly discounting the present challenges or if it is presently overextended.

Strange times create opportunity. For example, Aimia Inc. (AIM.TO) now trades for a bit more than \$2 per share, while the company has a bit less than \$3 per share in cash as well as interests in operating businesses that could be worth another \$8 or \$9 looking out a few years. This value won't be realized tomorrow, and there will be challenges to face between now and when value is ultimately realized, but insiders are strongly aligned with minority investors and have been aggressively buying shares in the open market. As always, I believe our best path forward is patience.

## **ADW CAPITAL – ADAM WYDEN**

Our objective is to find small and/or under-followed businesses primarily in the U.S. and Canada. Given the wide range of possible paths for the economy, my largest new position is a “special situation” that we believe presents an attractive risk/reward regardless of the path of re-opening the economy or the strength of the consumer. API Group (APG) trades at 5X cash flow and operates as a nationwide essential service in stable end-markets not exposed to COVID or work-from-home dynamics. Earlier this month, the company moved its listing from the LSE to the NYSE and is thus now eligible for inclusion in major indices.

Over the seven weeks subsequent to the NYSE listing, over 30M APG shares need to be purchased by index funds and those that track them. At a minimum, these forced buyers will be insensitive to price or COVID-related factors and should provide a floor to the APG's share price, which we believe is undervalued and underfollowed. These purchases may provide a substantial catalyst, creating an attractive non-correlated risk/reward in a time of heightened uncertainty. Public specialty industrial comparables, such as Honeywell (HON) or Johnson Controls (JCI), trade in the range of 15-18x EPS. Given that we believe API's business is superior to most of its public comparables, has a proven capital allocator/owner at the helm, and has an established framework to expand EBITDA margins over the next few years, we believe the APG stock should trade at a premium to its larger peers. At only 16x 2019 EPS, APG shares would trade at almost \$20/share or about a +110% return from today's prices.

## **DESERT LION – RUDI VAN NIEKERK**

It feels like no one is looking at South Africa currently. The market entered the sell-off already cheap, got cheaper, and didn't recover like the U.S. markets did. The void left by all the liquidity being sucked out of the market has abandoned many quality companies to trade at ridiculously cheap valuations.

For example, Balwin Properties (BWN.JO) is the largest listed build-to-sell residential developer in South Africa, building apartment complexes targeted at the growing middle-income class. Balwin is currently adding about 2,750 units per year, with an annual capacity of 5,000 as they continue to address the 700,000-unit demand



of their target market. Importantly, their brand has become known and respected in the country for its well-managed quality offerings. They also have the exclusive domestic rights to the Crystal Lagoons concept, which serves as an additional differentiating advantage. Balwin recently launched their biggest development to date and pre-sold the equivalent of 25% of the company's annual revenue in just the first four days. Those interested can watch the [launch event video](#), which includes an in-person address from South African President Cyril Ramaphosa.

With ~45% insider ownership and a market cap of about \$50m, Balwin is trading at less than 3X after-tax profits and less than 40% price-to-book. The balance sheet is rock solid and management's worst case scenario modelling indicates that the company can withstand 12 months of zero sales. This is a company that will survive and then thrive. The conservative base case assumes zero earnings for the current fiscal year, a normalization of the operating environment over the next four years, and an exit multiple of 7.5X earnings, for an expected compound return of +65% per annum.

#### **MARAN CAPITAL – DAN ROLLER**

Maran has been purchasing shares of a small (sub-\$100mm market cap) digital business services company whose core platform business is growing 30%+ with 80%+ gross margins. We believe the company is well-positioned to continue to grow through this tumultuous period, also bolstered by its rock-solid balance sheet with a net cash position of almost half of the market cap. After participating in the clean-up trade of a price-insensitive seller, our purchase price was just over 1X revenues and 7X EBITDA. We believe the company will double its EBITDA in two to three years, all while generating free cash flow and buying back stock.

In addition to continuing to hunt for hidden gems such as the above, we have been active on the special situations front. We discussed our Standard Diversified (SDI)/Turning Point Brands (TPB) parent-daughter arbitrage in our last two [letters](#), and are involved in several additional special situations today. Ideally, special situation trades have a highly asymmetric reward/risk profile with a firm catalyst in place and are uncorrelated to the market.

#### **TOLLYMORE – MARK WALKER**

Credit conditions of recent times have allowed weak companies to thrive. This event-driven macro crisis may expose those firms who have been swimming naked. Likewise, many investors, seduced by a decade of low finance costs, have geared up their investments, leaving them ill-equipped to invest counter-cyclically. Both dynamics may exacerbate quoted price declines. We must not be a bystander. Knowing what to do in a crisis and being able to do it are two different things. Capacity constraints are an important safeguard against permanent capital erosion, facilitating the ability to exploit mispricings and safeguard against being a bystander, a costly but common sin of many investment managers.

The paucity of appropriate capacity constraints is a function of widespread greed, something we hope to exploit. For example, we materially lowered our cost of ownership of Gym Group plc (GYM.L), the UK's low-cost gym chain, as the quoted price declined 75% peak to trough in swift recognition of the company's complete elimination of revenue generation due to social distancing plus high fixed costs. We believe that GYM's



liquidity is adequate to survive a prolonged period without revenues. Further, we recognize that recessionary conditions may accelerate a structural migration to low-cost gym membership, and consider the potential for a more consolidated market structure should smaller, less financially sound independent gyms shutter. These factors give us more conviction, not less, in GYM's incremental unit economics and addressable market size.

#### **LONG CAST ADVISERS – AVI FISHER**

I've recently opened a new position in nurse staffing company Cross Country Healthcare (CCRN), which serves an essential role helping hospital and healthcare clients solve their nurse and physician staffing needs. I've known the company a long time – I covered it as a sell side analyst many years ago – and it's long been a laggard. However, the company's co-founder returned last year, and the steps he's taken set Cross Country up on a solid foundation for cash flow generation and growth. During his hiatus, the co-founder ran two companies and started a third, which he sold in 2015 to CCRN's largest publicly traded competitor. Since his return, he's rationalized brands, added managed services clients, and initiated investments in overdue technology upgrades that offer scalability and cost savings (estimated \$8M-\$10M/year).

The business has some temporary COVID-related tailwinds, but also headwinds due to declines in non-COVID-related emergency room visits, operations, other deferred elective procedures, and school closures. Looking through this, I observe an inexpensive yet durable, cash-flow generating founder/operator company doing the right things to weigh the odds more favorably towards profitable growth.

#### **NORTH PEAK CAPITAL PARTNERS – MICHAEL & JEREMY KAHAN**

As much as we have tried to educate ourselves epidemiologically, we humbly accept that the dispersion of economic outcomes is unusually wide. The path for emerging from the crisis involves the interplay between scientific advancement (diagnostic, therapeutic, and prophylactic), public health response, population compliance, and myriad policy decisions at the local, state, federal, and international levels. Accordingly, we have focused on businesses with: (i) bulletproof balance sheets, (ii) predominantly variable cost structures, and (iii) recurring revenue. One example is our investment in ServiceNow (NOW), a SaaS computing platform enabling enterprise companies to digitize workflows. In the most recent quarter, the company grew – at scale – more than 30% and is expecting minimal impact from the coronavirus. We believe they have an extremely strong value proposition coupled with an enviable competitive moat that should propel success in a variety of economic environments.

#### **ARQUITOS CAPITAL – STEVEN KIEL**

Arquitos looks to the balance sheet first. Because of that, the companies we hold can weather any storm operationally. For companies in certain industries, this economic shutdown has caused revenue to drop significantly and, in some cases, even disappear. The companies that are running into trouble are those that still have large debt payments or other ongoing liabilities from aggressive financing. By avoiding those situations, we can be certain that the companies in our portfolio will survive in the short and medium terms. We believe this durability also can benefit them long term by giving them the opportunity to thrive by using this time period to take market share, buy back their shares at a discount, and, in some cases, take over competitors.



We have taken a new position in a company with these characteristics in the oil tanker industry: \$2B market cap Euronav (EURN) has a strong balance sheet, is returning a large amount of cash to shareholders, and is positioned to thrive in a competitive market. We believe Euronav can take advantage of shorter-term cash generation due to contango and disruptions in the oil markets, while still doing well when rates normalize due to their strong balance sheet and effective capital allocation decisions.

#### **FAR VIEW – BRAD HATHAWAY**

During March's volatility, Far View aggressively reviewed the investment theses for each of our positions. The focus of this analysis was to make sure that the companies had strong balance sheets to survive a long disruption and to estimate the impact of COVID-19 on each business. Some of our businesses have the potential to benefit from the changes to consumer and business behavior resulting from the pandemic and quarantine. For example, Far View's largest position, Naked Wines plc (WINE.L), has seen a significant increase in direct-to-consumer wine sales as COVID-19 has accelerated the ongoing shift to online channels. As we have seen in other industries, once consumers experience the benefits of an online model, they are unlikely to return to their prior purchasing patterns. As the leader in U.S. direct-to-consumer wine, Naked has the potential for a significant inflection in its business trajectory on a more permanent basis.

#### **FINAL THOUGHTS**

In March, as correlations rose to one, all that mattered were the macro forces. The pendulum swung back away from panic towards optimism in April and the S&P 500 recorded one of its strongest months on record. This is a good environment for stock picking, particularly in less crowded areas, though we all remain vigilant in assessing ongoing risks. Time will tell if this translates into investment performance for the underlying managers.

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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