GREENHAVEN
ROAD CAPITAL

July 2024

Dear Fellow Investors,

The Fund[1] returned approximately -5% net during the second quarter, bringing year-to-date returns to approximately -3% net. For context, the Russell 2000 was down -3.3% in the quarter and up 1.7% in the first half. Returns will vary by fund and investment class so please check your individual statements. Neither our YTD returns nor those of the Russell 2000 are exciting, but six months is a short time period and we have a concentrated portfolio that will have good bumps and bad bumps along the way. As outlined in the letter, I think the companies we own have continued to make significant progress that was not reflected in their share prices. I believe the market also has fundamental misunderstandings with some of our holdings that will resolve over time. July has been significantly more favorable for the Fund, which is now positive for the year.

It is too early to call a massive shift towards "small caps" but at least the conversation is happening, and July's data is encouraging with the Russell 2000 outperforming the Nasdaq by more than 1200 basis points so far. Large caps have had a decade+ run of outperformance, so this is a drop in the bucket. The cycles where large outperforms small and small outperforms large have historically lasted about 10 years. If investors decide that trees don't grow to the sky and they want to own smaller companies - we own a bunch of saplings at reasonable prices, with strong management teams, advantaged products, and favorable competitive dynamics. If capital flows to small caps, I think we are very well positioned.

Our results diverged from the larger indices in part because we did not own the largest companies. While I gravitate towards smaller and misunderstood companies, we could own the "Mag 7" and not owning them has been a painful choice.

There are two primary reasons for having avoided the "Mag 7" and their brethren. The first is the law of large numbers. Trees don't grow to the sky, and it is really hard to grow a $3 trillion company. Share price can increase by stretching the multiple further (Microsoft is at 14x trailing sales), but to actually grow earnings to support the next $3 trillion of market capitalization is a heavy lift requiring the addition of many hundreds of billions of dollars of revenue. Given their scale and the quality of the businesses, it is possible but certainly unprecedented.

The second reason for avoiding the Mag 7 today is that I am not convinced that the long-term winners have been anointed. The rise in their share prices would indicate that the game is over, but will the AI spending boom continue over a longer time horizon? Will there be returns to support it? Microsoft's capital expenditures are running at almost $300 million a WEEK and Google's are approximately $900 million a WEEK which is $180 million per business day. Meta has a similarly ambitious investment program. If Microsoft, Google, and Meta dial back their investments, Nvidia, whose share price has 10Xed in 2 years, may suffer. I look forward to experiencing the products that are created by generative AI over the next 10 years and investing in that wave, but I believe there will be fatter pitches than we are being offered today. Time will tell.

The baked-in optimism is not limited to the Mag 7. There are many examples, but a simple one is Nasdaq 100 member Costco. Its market capitalization ended June at ~$380B, implying a P/E ratio of 55x for a business that is growing systemwide square footage by 2.5% per year. It could be dead money for almost a decade to get to a P/E of 20. Costco is a great place to shop, but for me the investment case from here is harder.

[1] Greenhaven Road Capital Fund 1, LP, Greenhaven Road Capital Fund 1 Offshore, Ltd., and Greenhaven Road Capital Fund 2, LP are referred to herein as the "Fund" or the "Partnership."

Do You See What I See? Passive Investors and Quants

Frustratingly, several of the companies that we own have valuations that are far less demanding than the companies discussed above and I believe have brighter futures. As I approach my computer to look at our portfolio, I've recently found myself humming the children's song that opens with the question, "Do you see what I see?" In the second quarter, the market's answer was a resounding NO.

Having a divergent view from the market is not a new phenomenon. We often invest in companies that "do not screen well" in that the GAAP (Generally Accepted Accounting Principles) financials do not tell the full story, and in companies that are in transition where we believe that the historical financials are not indicative of future, or maybe even current, results. These misunderstandings and our variant perception often provide the opportunity to invest before the transformation or true quality of the business is fully reflected in reported numbers.

With an ever-increasing portion of market dollars being directed by "passive" or index investors, less and less fundamental analysis is occurring. Morningstar estimates that ≥50% of assets are now invested in passive funds.[2] Of the remaining active investors, a not insignificant percentage are likely closet indexers or following some sort of "quant" strategy.

Indices buy or sell based solely on their criteria for inclusion – often company size or industry. Their investors are not analyzing the individual companies. As for valuation, indices are often market cap weighted and designed to buy more of what is expensive and less of what is "cheap." There is also a large portion of the market that is "quantitative," looking at historical numbers to use past performance or "consensus estimates" as a proxy for future performance. With several of our companies being covered by only a handful of analysts, and with those analysts typically covering 25-40 companies, I find that the consensus estimates are often built on faulty assumptions, lazy extrapolations, or outdated information. It is fair to say that I am not investing my family's savings (or yours) based on consensus estimates. Maybe the quants' data is bad, but at least they are looking, unlike the indices.

Having a different view of a company is entirely useless if the market does not eventually come around and see the value I see. In some cases, the companies are cheap enough and generating enough cash that management can buy back shares to capitalize on the discrepancy, but, in general, the most likely path to getting paid is by having business progress show up in the reported financials. With the passage of time, the results should show up in the numbers, and the quants should eventually see what I see.

Do you See What I See? PAR's Progress

To help bridge the gap between what I see and what the market sees, we sent our investors an email with links to a series of fireside chats with the CEOs of some of our holdings. In these videos I am trying to tease out and highlight important qualitative factors that will show up in the numbers over the next year or two. If you did not receive the videos, please reach out to investorrelations@greenhavenroad.com. If you can only watch one, I would recommend this one with Savneet Singh of PAR Technology (PAR) (link).

[2] https://www.morningstar.com/funds/recovery-us-fund-flows-was-weak-2023

PAR had a transformative first half of the year, with accomplishments that include:

- Buying two companies: Stuzo closed at the end of March and TASK closed in July
- Selling their legacy, non-core defense business
- Starting to roll out their POS software to Burger King (less than 5% rolled out through June)
- Announcing Wendy's as a customer win (loyalty), though no software has been rolled out
- Beginning the rollout of their online ordering product (Menu), which was a financial headwind last year with all costs and zero revenue.
- Likely won but not announced two additional Tier One customers.

As you will hear in the video, the acquisitions have created opportunities that simply did not exist at the beginning of the year, including:

- A new payments product for convenience stores to roll out this year.
- Adopting Stuzo pricing on loyalty for existing customers, effectively raising prices.
- Developing a POS offering for convenience stores to be introduced at the end of the year.

It was a busy first six months of the year with a lot of fantastic progress.

Returning to the quality of consensus estimates and the idea of not using them to make investment decisions for my family's (and your) savings, as of quarter-end, four of the analyst estimates being used to form PAR's "consensus numbers" last updated their models in November 2023 according to FactSet. In this case, I think we know the answer to "do you see what I see?" An analyst model from November predates all of the positive developments outlined above. Will the reported numbers end up being different enough to matter?

According to FactSet, the consensus estimates are for continued EBITDA losses in Q3 of this year and only $18M of EBITDA next year. However, in both the video linked above and in the last earnings calls, the company has said they will be EBITDA positive in Q3 of this year. As for the 2024 EBITDA number, I don't think $40M is a stretch and $60M+ is possible depending on the investments being made, customer wins, and rollout cadences. So, based almost entirely on things that have already happened, such as winning Burger King and acquiring Stuzo, EBITDA profitability is coming sooner and 2024 EBITDA is likely 2-3X "consensus." This is why we do our own research.

With the sale of the defense business, PAR is much closer to a pure-play software business. As a result, they will likely change how they report results, better highlighting the attractiveness of its software business to the market. In addition, with the sale of defense and progress in the core software business gross margins will go up, growth will go up, and profits should inflect higher. This year, I believe that PAR should be able to grow its software business at 25%+ and should be a Rule of 40 software company next year. While that is not what the sell-side-analyst estimates from November 2023 say, I hope we are on the same page when their November 2024 versions come out. PAR ended the quarter at approximately $47. Our Q1 letter (link) laid out a path to $80 in a year, which is not quite a double, but if my view and the market view do converge, there is significant upside.

Do You See What I See? ALTG Interest Rates and Cash Flow

Alta Equipment Group (ALTG) is another example of a company where my view appears to be quite different from the market's view. I wrote about the company more extensively in the Q1 2024 letter (link), saying that:

> "An investment thesis should fit into a paragraph, or in this case a sentence… This business is (1) less cyclical than it appears, (2) generates more cash than it appears, with (3) less debt than it appears, with (4) a significant hidden growing annuity type asset, and (5) run by an owner operator who can grow organically and through acquisition for the next decade-plus, at an (6) attractive valuation."

Note that the paragraph above did not mention interest rates once. In fact, it speculated that ALTG was not particularly cyclical. Yet, just this month, at the first whiff of a possible interest rate cut, ALTG's stock ripped 10% on the first day and then another 25%+ over the following few days.

Mr. Market appears to be tying ALTG's prospects to interest rates. While lower rates will lower interest expense and may be beneficial to residential construction, Alta Equipment Group's new equipment sales are primarily tied to infrastructure and manufacturing spending, not residential construction. Infrastructure spending should be supported by the Infrastructure Investment and Jobs Act (IIJA), which allocates $1.2 trillion for transportation and infrastructure spending, and the Inflation Reduction Act (IRA), which allocates $369 billion for fighting climate change and providing energy security. Mr. Market can focus on interest rates, but I see infrastructure spending as the more relevant driver of future earnings and that has already been passed by Congress.

To further bolster the case that Alta Equipment Group may be less cyclical than some believe, here is another piece of data that is not in the "historic" numbers. Alta Equipment Group went public in 2020. Thus, most historical financial datasets for the ALTG begin in 2020 even though the company has been operating for 40 years. In 2009, when Alta Equipment Group was primarily focused on forklifts and their strongest geography was Michigan, their two largest customers were auto manufacturers who entered bankruptcy as auto volumes plunged. During this period, the worst in 50+ years for their largest customers wading through bankruptcy, Alta's Parts and Service business was down only 10%.

ALTG's cash-generating power is another place where few people seem to see what I see. The financials are complicated because five distinct business lines are forced to be reported in a single cash flow statement under GAAP accounting rules. There are Parts businesses and Services businesses. These are very attractive higher margin "razor blade" businesses. There are also two lower margin (but higher transaction value) businesses selling new and previously rented equipment. These are the low margin "razor" of the traditional razor/razor blade business model. Finally, there is an equipment rental business. The rental business is opportunistic and profitable, but basically exists to eventually sell equipment for future Parts and Service business. Five symbiotic business lines, one set of financial statements, the rules are the rules.

Last year, ALTG's rental business distorted its cash flow statement. Of its 40+ lines, two of them are explicitly related to the rental business – (1) proceeds from sale of rental equipment generated $128.9M, and (2) the expenditures for rental equipment used $62M. Looking at the cash flow statement, it appears that the rental business provided almost $67M of cash.

However, Alta Equipment Group typically takes rental equipment from inventory, so there is a supplemental schedule outside of the traditional cash flow statement. Quantitative investors are unlikely to adjust their numbers based on the schedule and passive investors don't even know it exists. The schedule is labeled "Net transfer of assets from inventory to rental fleet within property and equipment" and the impact was $180M. When this number is factored in, the rental business consumed roughly $123M of cash last year. I believe, and management has indicated that 2023's rental inventory investment included a ~$40M, one-time catch-up in inventory for the rental business, an anomalous holdover from inventory shortages during COVID.

The ALTG share price ended the quarter at $8, down 35% for the year. It is highly unlikely that the quants have connected the dots, and we know for certain that the passive investors don't even look. I see well more than 100% upside from the quarter-ending share price, as we should all see the cash pile up in the coming quarters.

The fireside chat with CEO Ryan Greenawalt should provide insights into the stability of the business and how they can navigate economic weakness in their end markets. As one of the newest holdings, the video is meant to provide additional context. (link)

Do You See What Kyle Sees? Hagerty Is Not a Traditional Insurance Company

Classic/collector car insurance company Hagerty (HGTY) is another holding where the GAAP financials and rote comparisons to "peers" are misleading. The Greenhaven Road view of Hagerty is formed by Kyle Campbell, who I initially brought on board to help with the Special Opportunities/SPAC investments. I believe that Kyle is the "Ax" (most knowledgeable investor) on Hagerty, which lies at the intersection of Kyle's love of cars and complexity. Similarly to ALTG, Hagerty is not just in one business. They have a direct insurance business, a partnership insurance business model where they partner with 9 of the 10 largest auto insurers and all of the top 10 brokers by revenue, as well as a reinsurance business, a marketplace business, and a membership business. Like ALTG, these are all rolled into a single set of GAAP financials. If you just pull the company up on Bloomberg and compare them to other "insurance" companies on a price-to-book or price-to-earnings basis, you will want to short it. The high-level screen is what most people see.

Without giving away all of Kyle's sources, suffice it to say that he is not waiting for sell-side research to inform his view. Kyle looks forward to the Hagerty Reinsurance filings with the Bermuda tax authorities the way Knicks fans are looking forward to the season opener this year. Hagerty owns several car shows as part of their stated mission of keeping car culture alive, but these also serve as a customer acquisition and retention tool. Kyle will go to their Greenwich, Monterey, and Amelia Island car shows, partly because he loves cars and they are fun, but mostly because the top 20 Hagerty employees are at those events. Nobody is dishing out material non-public information at these events, but if you want to understand the marketplace business and how Hagerty members perceive these initiatives, attending the auctions sure helps. The mosaic Kyle has developed is far richer than the GAAP financials.

He recently presented HGTY at MOI Global's Wide-Moat Investing Summit. Here is a link to his presentation (link) to help you see what Kyle sees and help explain why Markel owns 23% of the company and State Farm invested over $550M.

TOP HOLDINGS

In addition to the previously discussed PAR and Hagerty, other top holdings include KKR, Burford, and Cellebrite.

Cellebrite (CLBT) – After the quarter ended, Cellebrite was in the news for an unfortunate reason. When the FBI was trying to open the phone of the man who shot at former President Donald Trump, they could not do it in the Pittsburgh field office. The phone was sent to Quantico where the lab technicians used Cellebrite tools and had it open in approximately 40 minutes. This speaks to the power of the tools as well as the ability to sell more licenses within existing agencies such as the FBI. In a perfect world, Cellebrite's products would not be needed. In real life, law enforcement agencies will continue to demand the products and technologies Cellebrite offers to support the ever-growing challenges presented by investigating crimes in an increasingly digital world.

Burford (BUR) – In my last letter, I included the ancient Greek saying, "The wheels of justice turn slowly, but grind exceedingly fine." Burford continues to work through a backlog of cases that were slowed by COVID court closures. We expect that the fruits of their labors will begin to be more evident over the coming quarters as they close out longer-duration cases and recognize what are likely large gains on their original capital deployments. As a reminder, their largest "holding" is a $6.2B (~$28 per share) judgement against Argentina related to the YPF case. Each passing day sees nearly $1M of interest accrued to the judgment, which equates to ~$1.40 per share annually for Burford. While there is likely to be a negotiated settlement with the Argentinian government for an amount less than what is owed, Burford's share price indicates that they will recover nothing from YPF and nothing from their investments in substantial meat-related antitrust cases, while assigning minimal value to their asset management business. We have no way of knowing for certain what the precise recoveries will be from these cases, but the risk/reward skew is very attractive from an investment standpoint.

KKR (KKR) – The core of my KKR investment thesis is simple: AUM is going up, up, up. In previous letters, I've discussed in more depth why I believe growth is inevitable at KKR. They have the people, products, and business model with a track record of success operating in a market that continues to demand larger allocations of capital.

Interestingly, in the last quarter, two high-net-worth individuals I know mentioned they had been steered towards alternative investments offered through their wealth advisors. This should be a more frequent occurrence as KKR and other alternative mangers increase their focus on "High Net Worth" and "Mass Affluent." This past quarter, KKR announced a deal with Capital Group, which manages over $2.6 trillion. As Capital Group said in their press release:

> "While alternatives have been available to high-net-worth individuals and accredited investors for some time, mass affluent investors, which represent more than 40% of the wealth market globally, have not historically had access to the asset class. This combination of Capital Group and KKR opens the door for more financial professionals and their clients to access alternative investments as part of their portfolios."

"High Net Worth" and "Mass Affluent" typically have a private equity / private credit allocation of near zero. It is an easy sell for a wealth advisor, and the fees/commissions can be materially higher than an index fund. The conditions are ripe for more and more of your friends to be sold "alternatives". I am not saying that investing in KKR's retail focused funds will be great investments, but we own KKR, which manages those funds. AUM is going up, which means fees are going up, and with the operating leverage inherent in the model, earnings are also going up.

Insider Ownership

I have spent pages writing about discrepancies between what I see and what the market sees. One area where we see the same thing is insider ownership. We own several companies with very high insider ownership including:

- KKR: Founders continue to hold ~20% of the shares outstanding and employees own an additional 10%+
- Cellebrite: CEO owns ~2.5%, early strategic investor Suncorp owns ~47%, strategic partner Axon owns 4.8%, and SPAC sponsor/board member True Wind owns 6.5%
- Hagerty: Founding family owns ~52%. Strategic investors, Markel and State Farm, own 23% and 15%.
- Burford: Combined holdings of the two co-CEOs is ~10%
- Alta Equipment Group: CEO and his family owns ~23%.
- International Workspace Group (discussed in last letter): CEO owns approximately 25% of the company

While high insider ownership does not guarantee anything, I view it as decreasing the likelihood of misguided acquisitions or short-term thinking and an indication that management is thoughtful about capital allocation.

Shorts

We remain short the flying taxi company that has the trifecta of regulatory risk, technology risk, and business model risk – and you could arguably throw in a healthy dose of execution risk. We are short two companies facing significant litigation with the potential for treble damages (i.e., 3x the actual amount) for their actions and potential liabilities far in excess of their market capitalizations. The litigation will take time to play out, but given the low margins, commodity nature of their product, and capital intensity, I believe it is an unlikely candidate for a GameStop-type short squeeze and believe it has the potential to decline by 50% or more. We are also short two major indices and bought some "insurance" in the form of out-of-the-money options in late December when option prices made the risk/reward more palatable. The puts will soften the blow of any major decline in equity prices and are both an insurance policy and allow us to remain invested.

Outlook

We are clearly entering a period where there will be a lot of cross currents. There is an election in the U.S. where we don't even know the final candidates. However, we do know that jawboning on tariffs, corporate taxes, foreign policy, and other policy proposals will roil through the financial markets. Interest rate cuts are on the horizon. While most of these headlines will have virtually no impact on the operations and earnings of the companies that we own, the multiples investors are willing to pay may gyrate. I expect more volatility. Over time, however, I think that the market will see what I see, there will be a convergence in the reported numbers, analysts will adjust their models, and cash will still be cash.

Thus, I am going to end this letter as I did last letter…This is not easy or fun right now. This is the slog as we wait for the share price to budge, but we are backing some very talented teams attacking large markets with secular tailwinds. In this case, I think Charlie Munger is right again—the big money is in the waiting.

Sincerely,

Disclaimer:

This version of the letter is modified from the original version sent to limited partners in July 2024. The following passage was removed "The reason I am boring you with a play-by-play of the ALTG cash flow statement and supplemental schedules is that, with 33.2M shares outstanding, this one-time investment in rental equipment, buried in a separate schedule, reduced cash by $1.20+ per share. If you value ALTG at 10X normalized free cash flow, the "missing" $1.20 per share of normalized free cash flow would equate to an extra $12 of share value." Upon further diligence, the incremental inventory is reflected on the floorplan debt for rental equipment and only the equity portion would be reflected in cash.