

Maran Partners Fund LP

Founder's Letter

2Q 2015

Dear Partners,

Maran Partners Fund, LP commenced operation on June 1, 2015. As this is my first letter to partners, I will review some of the principles upon which Maran Capital Management was founded and which will guide its operation.

Maran Capital Management is an unconventional investment manager. I feel that it needs to be, as it is aiming for unconventional – that is, superior – results.

I am doing things differently than the vast majority of institutional asset managers not just to be different, but because I am guided by logic. The decisions I have made regarding both the structure and operation of the management company, as well as the fund management process and philosophy, are driven solely by the quest for superior investment results.

Maran Capital will never have multiple strategies, multiple portfolio managers, investment committees, or teams of analysts. The fund will have a single capital allocator – me – and any successes or failures will be solely attributable to me.

I have a firm commitment to disciplined value investing with a focus on inefficient areas of the market. I take a long-term approach, focus on my best ideas, and am comfortable holding cash in the absence of compelling ideas. I am committed to keeping the fund small, and the firm lean.

My goal is to maximize the long-term compounded return of the partnership, after all fees, expenses and taxes, while minimizing the risk of permanent capital loss. I believe Maran's structure, philosophy, and approach give me the best chance of achieving this goal.

Disciplined Value Investing Philosophy

I am a value investor. I seek securities that I believe are trading at large discounts to intrinsic value and present minimal risk of permanent capital loss. My goal is to find securities trading at 50 percent or less of intrinsic value (or "three-year doubles") that I think also have limited downside.

My preference is to buy well-run, outstanding businesses at rock-bottom prices. Unfortunately, that combination is rare. Thus, I will look at both excellent businesses (which may be temporarily out of favor, unloved, or fall into various special situation categories), as well as lower-quality businesses or those that are underperforming and in need of improvement. In either case, I am looking for a price that is significantly less than intrinsic value, as well as limited downside risk.

I intend to maintain flexibility regarding the universe of stocks in which I will look for value – I can't know a priori where an attractive opportunity may arise. However, over my decade-plus of investment management experience, I have found what I believe is a generally attractive hunting ground for opportunity.

I believe investment opportunities frequently arise in a variety of special situations, event-driven situations, or in companies otherwise undergoing various types of change. Examples include, but are not limited to:

- corporate events, including M&A transactions, broken deals, spin-offs, divestitures, asset sales, rights offerings
- IPOs and/or broken IPOs
- change in capital structure, ownership, shareholder composition, or corporate governance
- distress, bankruptcy or post-emergence
- restructuring, reorganization
- leadership or executive changes
- change in industry structure
- change in corporate strategy

I believe any of these special situation categories can be a source of opportunity, but there are times when stocks get mispriced for any number of factors. Opportunity may be present in misunderstood large-cap stocks, smaller-cap stocks that are under-followed, companies or industries under temporary duress, companies with hidden assets or understated earnings, and/or securities that are subject to implicit or explicit institutional ownership restrictions or are otherwise the subject of forced sellers.

Chip Shots, Slam Dunks, No Brainers...and Cash

One friend calls them chip shots, but I suppose two-inch putts would be a better metaphor. Regardless your metaphor of choice, the idea is fairly simple. I'm seeking out high-conviction ideas – I never want to “force it.” We want to sleep well at night with the stocks in our portfolio. In the absence of high-conviction ideas, I believe holding cash is the sanest choice. There is an opportunity cost to being fully invested. I will use an even higher bar for the last 10 or 20% of the portfolio capital than I will for the first 50 or 60%. If I'm primarily looking for two-to-three year doubles, then the last 10 or 20% of capital might be deployed only into what I believe are two-to-three year triples or quadruples.

Owning like an Owner

I take a business-like approach to investing in securities. I approach the purchase of a small fraction of a public company as if I were buying the entire thing. This speaks to the level of due diligence that I perform before buying a security, as well as the role I intend to take once we are partial owners of a business.

Regardless of the size of our position, and thus our vote, I intend to be an involved, active shareholder. This may mean discussing with management ways to unlock value or properly allocate capital, voicing dissenting opinions in private or public, or taking a more active role in bringing about change.

“Activist investing” has become increasingly popular over the last few years. While it means many things to many people and can present as collaboration behind the scenes or hostile public theatrics, at root I welcome the trend of shareholders exercising their rights with respect to companies they own.

Too many boards and management teams seem to have forgotten for whom they are running companies. I take good corporate governance extremely seriously, and I find it disappointing that so few shareholders approach their rights as owners, including proxy voting, so carelessly. We shareholders own our companies! If they are being run with poor corporate governance, lack of shareholder alignment, or quite

simply have not performed up to their potentials over long periods of time, then I believe it is a shareholder's duty to voice dissent or act to create change.

Concentration

I intend to concentrate our capital into very few positions. I believe it is less risky and more profitable to concentrate the fund into a few positions that I have researched thoroughly and are compellingly valued than it is to diversify the portfolio widely into companies about which I know less or are more expensive. In general, I believe my top handful of ideas are likely to be better than my 30th best idea, and will manage the portfolio accordingly.

It bears repeating, especially since this belief is so anathema to the vast majority of the investment industry: I believe my concentrated approach is less risky than a more diversified portfolio. I might add parenthetically that this is especially true if said diversified portfolio is diversified into a collection of over-valued assets.

However, a concentrated approach is likely to be more volatile. Volatility is generally our friend – it creates opportunities to purchase securities at wider discounts to intrinsic value. I would much rather live in a world with 80% annual peak-to-trough stock price swings than 20 percent swings. I do not equate volatility with risk. To me, risk is the risk of permanent capital loss, not shifts in the temporary marks in the quoted levels of securities.

Risk Management

“Rule No. 1: Never lose money. Rule No. 2: Never forget Rule No. 1.” Widely attributed to Warren Buffett, it must be one of the most frequently quoted aphorisms on value investing.

Charlie Munger, the arguably wiser but less-celebrated member of the Berkshire Hathaway managing duo, was also fond of framing his investment advice in the negative. He quoted algebraist Carl Jacobi, who suggested that problems are frequently easier to solve when working backwards. “Invert, always invert.” In various speeches, Munger gave colorful examples about success – or more specifically, how to avoid failure. I paraphrase: “How would you guarantee failure? Well, you'd do drugs, cheat on your spouse, break laws, etc., etc.” Yes, there are many ways to succeed, but there is one piece of universal wisdom that applies to success: to succeed, you need to avoid failure.

Fellow value investor Monish Pabrai codifies this approach in his book, *The Dhandho Investor*: “Heads I win, tails I don't lose much.” Benjamin Graham simply called it margin of safety.

I approach the business of investment management from the perspective of focusing on risk first – that is, avoiding failure – primarily at the individual security level. Where can we get hurt? What is the downside? What am I missing?

Our portfolio is invested in cash and a concentrated group of what I believe are minimally risky securities that also offer substantial upside given their large discounts to intrinsic value.

A friend at a large mutual fund complex recently told me that “everything is expensive, yet our clients are paying us to be fully invested, so we're doing our best to find the least-bad alternatives.” In other words, they were knowingly investing in stocks they believed to be overvalued because they had an institutional

mandate to be fully invested and diversified. I'm sure similar comments were made by tech fund managers in January 2000.

Howard Marks addressed the challenge thus:

“The money manager’s job isn’t just to make investments with profit potential, but also to give clients what they want, since most institutional investors are hired to carry out specific assignments in terms of asset class and investment style...Whether prices are depressed or elevated, and whether prospective returns are therefore high or low, we have to find the best investments out there. Since we can’t change the market, if we want to participate, our only option is to select the best from the possibilities that exist.” – Howard Marks, *The Most Important Thing*, page 101

The job of an investment manager is to select the best from the possibilities that exist. That is almost a tautology. But I reject the implication that it is ever acceptable for a manager to own securities he or she believes are overvalued with the rationalization that they are the “least bad” of the current set of possibilities.

Maran Capital was formed to protect capital first. I am striving to maximize the compounded return of that capital given that initial constraint. If our portfolio contains more cash for certain periods of time while I am searching for compelling ideas, so be it.

There are many types of risk – some that I welcome or am at least comfortable with, and some which I will fiercely attempt to avoid. The key risk that I am seeking to avoid, as I have stated, is the risk of permanent capital loss. I am comfortable with the risk of short-term underperformance vs. the market, with looking different, with volatility.

Because I am comfortable with some volatility (which I believe is an unavoidable side-effect of a concentrated portfolio), some will call my strategy riskier. Again, I believe it is actually more conservative.

Research

A critical element of minimizing risk is intense research. I must know what we own in order to have an opinion regarding its value.

The research process starts with idea generation. I continually track a long list of special situation categories, many of which I highlighted above. I have a long list of companies and sectors that I have covered as an investment analyst over the last 10+ years, and an extensive personal network that includes investors, analysts, executives, and private business owners. I monitor insider, targeted investor, and select activist investor SEC filings, frequently trying to reverse engineer the ideas of those I consider smart investors. I also read a lot, including what I think is a reasonable amount of material that is uncorrelated and outside of the mainstream – blogs, tweets, obscure periodicals, etc. I attempt to maintain and grow my circles of competence daily.

Fundamental research and valuation is an iterative process. As I am analyzing a given thesis from both sides – that is trying to disprove it as much as prove it – I am continually thinking about how to value the business. Quantitative and qualitative analysis, forensic accounting analysis, and the identification of

potential catalysts all go into this process. I try to take a quantitative, data-driven approach to valuation, while maintaining a healthy skepticism to advanced math and too much precision – common sense and good judgement are paramount.

Never afraid to steal (or at least borrow) from the best, I have implemented the concept of a checklist in my investing process. Popularized in value investing circles by Monish Pabrai following his reading of *The Checklist Manifesto* by Atul Gawande, a checklist is a formulaic process by which to further attempt to reduce risk and avoid biases in the research process. As Richard Feynman said, “the first principle is that you must not fool yourself, and you are the easiest person to fool.”

My checklist is over fifty items long and includes such topics as: leverage; cyclicity; inside ownership and share buybacks; metrics on quality of business; ways downside is protected (balance sheet, earnings power of the business, FCF); and more. I try to grow the list by observing the mistakes of others, but from time to time the list grows by the lessons hardest won – that is, mistakes made by yours truly.

Market Backdrop

I generally do not attempt to form an opinion on the overall level of the stock market, and I never attempt to forecast where it may trade in the short term. I am simply focused on finding undervalued securities. However, I am cognizant of the fact that we are in the 7th 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. I’m reminded more and more of the summer of 2007.

Howard Marks recently commented: “We are at a point in the cycle where we feel virtually all assets are trading above their intrinsic value; some are in ‘highly priced’ territory, and there are few absolute bargains available.” (Source: [Bloomberg](#))

Jeremy Grantham, of GMO, shares the view: “Probably the best two measures of market value – Shiller P/E and Tobin’s Q – have moved up over the last six months to 1.5 and 1.8 standard deviations (sigma), respectively. So, just as with the price-only series, they are also well on the way to bubble-dom but, clearly enough, not there yet.” (Source: [GMO 1Q 2015 Letter](#))

With that as the backdrop, I am still very comfortable and indeed excited to be launching an investment fund that I expect to be materially net long, and to be dedicating the majority of my family’s investment capital to it.

While many securities and the market as a whole may be overvalued, I am still finding a number of very attractive securities in which to invest our Partnership’s capital.

I think several aspects of my approach – concentration, a focus on special situation/event driven situations, the willingness to hold cash to deploy during periods of downward volatility, the ability to look at smaller-cap stocks and those that are uncovered or off the beaten path – should serve to lower the correlation of our portfolio to that of the broader market.

Interestingly, both Marks and Grantham go on to state their personal beliefs that there may be further upside near-term, despite apparent wide-spread over-valuation.

Marks: “However, on the basis of our history with cycles, we believe there’s somewhat further to go before we reach peak exuberance, and thus peak prices.” (Source: [Bloomberg](#))

Grantham: “For me, recognizing the power of the Fed to move assets (although desperately limited power to boost the economy), it seems logical to assume that absent a major international economic accident, the current Fed is bound and determined to continue stimulating asset prices until we once again have a fully-fledged bubble...So, “2250, here we come” [for the S&P500] is still my view of the most likely track.” (Source: [GMO 1Q 2015 Letter](#))

If they prove to be right and the market continues to advance at a high rate, our partnership runs the risk of under-performing near term. I would be untroubled by this. Over the long term, I believe my approach has less risk, and the potential for more reward, than the overall stock market.

The Right Partners for a Long-Term Focus

“Having clients with a long-term orientation is crucial. Nothing else is as important to the success of an investment firm.” – Seth Klarman

I am seeking long-term partners in the fund, as I seek to manage the partnership on a long-term basis. I intend to take advantage of the time horizon “arbitrage” between our longer-term outlook and that of the vast majority of investors today.

One to three years is too short of a time frame on which to accurately evaluate results. I believe five years is the minimum period on which results should be judged – the longer the time period, the more meaningful the result.

While maximal absolute returns are the objective, the S&P500 is a reasonable benchmark against which to compare our results over the long term (5+ years, or a complete market cycle). Most funds fail to beat the S&P500 over time.

The statistics vary slightly over time periods and benchmarks, but in general only 10-20% of funds will outperform the market after fees on a long-term basis. And less than 1% of funds will outperform by greater than 3% per year over the long term.

If I can’t outperform the market after fees and expenses over long periods of time, I should be replaced by a low-cost index fund (and find another line of work!).

As I stated, I believe volatility is generally a poor measure of risk. There is one scenario in which volatility could pose a real risk to the fund – that is if someone panics (either me, or a sufficient number of LPs), such that we are forced to realize losses during what is otherwise a period of market volatility. Volatility coupled with poor psychology can be trouble.

Therefore, I am committed to partnering with limited partners who share my long-term orientation, and are comfortable with the trade-off between volatility and higher expected long-term returns. I believe the fee structures, marketing approach, and investor communications are all aligned to this end.

Size

Our smaller size is a key competitive advantage. I am 100% focused on returns – not on asset gathering. I will close the fund before size becomes a hindrance.

Of course, I welcome new partners, and indeed in the short term all partners will benefit from a larger capital base over which to amortize our operating expenses. Longer-term, with very few exceptions, too large of an asset base is a headwind to returns, and something that I will fiercely avoid.

Conclusion

I am grateful for the responsibility and opportunity to protect our capital and shepherd its growth. I look forward to a long and hopefully fruitful partnership. Thank you for your 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.

The statements of the investment objectives are statements of objectives only. They are not projections of expected performance nor guarantees of anticipated investment results. Actual performance and results may vary substantially from the stated objectives.

An investment in the Partnership involves a high degree of risk and is suitable only for sophisticated and accredited investors. Investors should be prepared to suffer losses of their entire investments. The Offering Memorandum contains brief descriptions of certain of the risks associated with investing in the Fund.

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