

October 23, 2017

Dear Partners and Friends,

The return of Maran Partners Fund, LP in 3Q 2017, net of all fees and expenses, was +4.9%¹. Year to date through September 30, 2017, the fund was up +12.1%. For the many partners that have elected to invest in share classes with longer commitments and lower fees, net returns are better. The timing of subscriptions also influences individual partner returns. Please review your individual account statements for details.

This quarter marks the fifth quarter in a row in which the partnership recorded positive performance. While a nice result, we shouldn't read into this. The partnership will inevitably have quarters – and indeed years – in which performance is negative. Just as you should not care about the fund's performance on any given day or week, I believe there is little value in judging the results over any single quarter or even year.

Broader market volatility remains low. 2017 thus far has seen one of the lowest intra-year drawdowns on record (if the year ended today, this year would come in second place to the -2.5% maximum drawdown in 1995). We should not be particularly surprised at this, nor should we look to it as evidence of what is to come next in the short term². While many stocks appear expensive, I believe that trying to predict the short-term movements of the market – or of our partnership – is futile.

My goal remains unchanged: 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 remain steadfast in my unconventional approach. The masses preach diversification without regard to valuation; I believe my concentrated, long-term, and value-driven approach gives me the best chance of minimizing risk of loss while creating the opportunity to compound capital over time.

This concentrated approach will likely lead to lumpy results, and will involve periods of underperformance versus the broader indices. Indeed, during speculative bull markets, the odds of our partnership underperforming increase. I'm fine with this. I am focused on the universe of opportunities that I can understand. If I miss out on high returns from speculative Initial Coin Offerings (one of the trends du jour), or a sector-focused Russia fund tops the annual hedge fund performance rankings, I'm indifferent. And if the broader market moves higher on valuation multiple expansion in a small group of companies with large index weightings, it doesn't bother me.

¹ Based on a hypothetical investor who invested at fund inception and is paying a 1% management fee and 20% incentive allocation. Individual partner returns may vary based on fee structure and timing of investments. Please see disclaimer on page 5 for important information.

² Given that stock markets reside in the stochastic world of fat-tails (Nassim Taleb's "Extremistan"), we should not be too surprised when we see new "extreme" events in either direction – that is, new extreme maximums or minimums in variables such as volatility. Similarly, a lull in volatility does not imply continued low volatility, nor that an increase in it is imminent. The concept of reversion to the mean only applies in the Gaussian.

Turning Point Brands (TPB)

The primary purpose of these letters is to keep you apprised of our performance as well as my philosophy and approach. I try to be transparent and informative regarding our core positions. The letters also of course serve a marketing purpose; I think they serve as the single best introduction for prospective investors to Maran Capital Management (feel free to pass them along to like-minded investors). That said, when the goal of marketing comes into conflict with the goal of maximizing investment performance, you can bet that investment performance will take precedence.

It is for this reason that I will hesitate to discuss positions, especially those that are less liquid, to which the partnership is still adding. In the first quarter letter this year, I mentioned a new core position that the fund was in the process of buying. It is currently our third largest position, and has been since late in the first quarter.

In my 1Q 2017 letter, I wrote:

The company is an undiscovered, high-quality, branded consumer goods company with accelerating growth. It has enviable financial returns (50%+ return on tangible capital) and was purchased at what I believe is a compelling valuation. With industry peers trading at FCF multiples in the low-20s, we paid about 10x FCF. Insiders own over 70% of the company and were significant net purchasers of the IPO last year. I generally try to underwrite for three-year doubles (or “fifty cent dollars”) with limited risk of permanent capital impairment. I think this fits that bill.

The company is Turning Point Brands (TPB). It is engaged in the manufacture and distribution of, in industry parlance, *Other Tobacco Products* (OTP) – that is, tobacco products other than cigarettes. In their case, this encompasses chewing tobacco products, rolling papers, e-cigarettes, and other vaping products and accessories.

This is a decidedly unsexy product and industry. While not in secular decline like cigarettes, Turning Points’ end market is only expected to grow in the low single digits. Yet this investment ticks many of the boxes I look for in an investment: rational industry structure, pricing power, significant growth potential via M&A and penetration, and an aligned management team. We acquired our shares at what I think is a large discount to fair value.

Metaphors and Pattern Recognition

Enclosed in the appendix is a write-up that I did on Turning Point as I was in the process of acquiring the shares; it provides an overview of the company and my thesis. Feel free to read it before returning to this section.

When I study a company, I generally try to create a framework for how the company works, what the drivers are, and what the incentives are, among other things. I will watch for patterns that recur across companies and industries; frequently, this will take the form of a metaphor. Of course, these models can be instructive, but also can lead astray, so I try to use them with care.

What follows is a more in-depth discussion of two of the frameworks that I have been using in thinking about TPB, and which I think make it particularly interesting.

Pricing Umbrellas – The Packaging Corporation of Tobacco

Industry consolidation leading to pricing power can be a powerful investment theme. The containerboard (cardboard box) industry is a good example of this. Over the last twenty years, the industry has consolidated significantly. In 1997, the top five companies made up less than 50% of industry capacity, with no company having more than 13% market share. Today, the top two companies together have over 50% market share in the US, while the top five have ~75% market share. Making cardboard is a high fixed-cost, capital intensive industry. The leverage that containerboard companies have to pricing is dramatically higher than that which they have to volume. The vast majority of price increases or decreases fall to the bottom line, while only the incremental operating margin on volume falls to the bottom line. Cutting price to pick up a little market share would be a terrible proposition.

The industry consolidation that created a more rational structure is a positive for all players in the industry. That said, it is *especially* positive for the smaller players. The duty to keep supply and demand in balance largely rests on the shoulders of the large players. This creates a pricing umbrella for some of the smaller players. It allows them to run at full capacity (or even grow volumes – that is, gain share) without lowering prices.

Packaging Corporation (PKG) is very well-run and has numerous favorable attributes; I don't intend to argue that its success over the years is solely attributable to industry consolidation and associated benefits. But it has certainly helped. While the large players have generally tried to manage capacity to keep supply and demand tight (and thus keep pricing stable or rising), PKG has consistently taken share. PKG's organic volumes are up 68% over the last 20 years, while overall industry volumes have shrunk slightly. Basically, the consolidated industry structure, and resulting pricing umbrella, has allowed PKG to be a bit of a *free rider* in the industry. It has had very powerful results, as a glance at PKG's long-term stock chart will show.

I hope the parallels to the tobacco industry are immediately apparent (including the fact that industry volumes in each case are flat to slightly declining). TPB is a small player in a highly consolidated, rational industry. The tobacco majors are almost certain to continue focus on price (even at the expense of a little market share loss), which should allow TPB to share in the industry price gains and also to grow volume organically. It is an enviable position.

Buy and Build – The Watsco of Tobacco

While roll-ups are not without their risk (there are more than a few highly-levered roll-ups in the short-selling hall of fame), they are also responsible for some major success stories in corporate America. TCI under John Malone made 482 acquisitions between 1973 and 1989³, and Berkshire Hathaway has similarly made hundreds of acquisitions over the last few decades. Less heralded but nevertheless extremely impressive roll-up stories include Heico (airplane parts) and Watsco (HVAC distribution).

In each of these cases, the companies used cash flow from operations, debt, and equity as currency for deals. For example, Watsco (WSO) has acquired 59 HVAC distributors since 1989, typically paying 4-6x EBITDA, while WSO itself traded at double digit EBITDA multiples. This seemingly simple strategy, in a boring, stable industry, yielded incredible results. WSO returned over 6200% over the last 25+ years

³ William Thorndike, *The Outsiders* (2012), 92.

(18%+ compounded) by buying (at very favorable prices), and then integrating and growing, a large number of businesses in its niche.

Watsco calls this their *buy and build* strategy, and I think it is a good metaphor for what Turning Point is attempting to do. The *buy* element is evident in TPB's two recent acquisitions (each at around 4x EBITDA), and the *build* element can be seen in their organic growth (adding salespeople, products, regions, as well as growing/improving the purchased businesses).

Two deals do not make a trend, yet the highly aligned management team has made it clear that their goal is to make it just that. If TPB can continue to buy assets for 4-6x EBITDA while they themselves trade at double digit multiples, it should create a very powerful effect. (For more on why TPB has been able to purchase assets at such low multiples, see the appendix; in short, they are one of few buyers at the small end of the market and are dealing with "forced" sellers – due to increasing regulatory burdens – in small, family-owned companies).

Importantly, I believe that the partnership purchased TPB at a valuation that is very attractive for what the company is right now. I am not counting on a string of successful acquisitions, significant pricing increases, nor organic volume growth. But if my metaphors are close to accurate – if TPB can grow volume while benefitting from a pricing umbrella held aloft by a rational, consolidated industry, and if TPB can continue to buy stable or growing businesses at 4x EBITDA multiples – then our purchase price will turn out to be very attractive, and this could be a compounder for years to come (until the likely end game transpires, which is a sale to one of the tobacco majors).

Mistakes Were Made – By Me

One of my best friends in college told me the story of his high school Advanced Placement Chemistry class at a competitive Connecticut high school. His teacher had demarcated a section of the wall – I can almost picture it between the periodic table and the chalk board – which was labeled the "Wall of Shame." The Wall of Shame was reserved for the names (could it have been the pictures, too?) of any student that received less than a top score of five out of five on the AP Chemistry exam (a notoriously difficult exam). Astonishingly, this Wall of Shame stood empty. Regardless of the veracity with which the teacher kept the wall bare, I can imagine that it would have served as a powerful motivator to students in the class.

This is a great concept; I have been utilizing versions of it since I first heard this story. Unfortunately, my own investment Wall of Shame is littered with past bad ideas and mistakes (not to mention the errors of *omission* which can also be costly). But I nonetheless attempt to confront them head-on, in an effort to continuously learn and improve.

Since launching Maran, I have made a number of errors which fall into the same category: statistically cheap stocks. That is, stocks that appear cheap based on the balance sheet, including Ben Graham *net nets* (stocks trading at discounts to current assets less total liabilities) or those trading for negative enterprise values. A temporary employment company and a brick-and-mortar retailer, each *net nets*, were small positions that I sold at losses (permanent destructions of capital) after the companies burned cash and shrank intrinsic value.

While CafePress (PRSS), which I wrote up my 1Q 2016 letter to partners, is not yet on my Wall of Shame, it is beginning to look more like a mistake. The stock has traded at or close to a zero enterprise value for most of our holding period, yet sales have eroded and the net cash balance has declined. I took solace in what I thought was a very significant alignment of interests – the top four shareholders own almost 70% of the company. I thought they would be loath to whittle away the cash balance and would ultimately sell the company if they couldn't successfully effect a turnaround.

Thus far, a turnaround has not materialized, and obviously, the company has not been sold. I am monitoring it closely. I still think that the cheap price and alignment of interests should be enough to create a reasonable outcome, but the course of events to date is enough to have me thinking harder about statistical cheapness and the various components (both price and quality) that make up a margin of safety.

I have added additional items to my investment checklist in response to these mistakes; I am trying hard to learn from them, and thus to reduce their occurrence and cost in the future.

Portfolio Update

At the end of the third quarter, the fund was 96% long by 7% short, for gross exposure of 103% and net exposure of 89%. The top 10 positions accounted for 91% of the fund's total capital.

Our top positions remained unchanged through the quarter, with the exception of the addition of the real estate-rich company that I discussed last quarter, to which I continue to add (see 2Q 2017 letter for high-level discussion; I will provide more detail when appropriate).

Clarus Corp (CLAR, formerly known as Black Diamond Inc)

Our largest position remains the same, but experienced a name change. Black Diamond Inc is now Clarus Corp (CLAR). The new name (a return to its NOL-shell roots) reflects its holding company structure, as the company has begun to make acquisitions outside of the Black Diamond Equipment business. In August, CLAR acquired Sierra Bullets for \$79mm, 6.6x free cash flow (a 15% yield). Sierra is a 70 year old company that makes precision bullets for target shooting, hunting, and military/law enforcement. The acquisition will be highly accretive. I think that CLAR can earn \$0.60 – \$0.65 next year, and \$1.00 in 2020. If this occurs as I expect, it will make the current \$7.35 share price look quite cheap.

Biglari Holdings (BH)

I added to our BH position during the quarter. A decline in profitability at Steak n Shake led to a significant sell-off in BH, which created what I thought was a compelling opportunity to add to the position. The company has a negative Enterprise Value at recent prices; that is, it is trading at less than the value of its cash and investment portfolio. We are getting Steak n Shake, Maxim, and the insurance subsidiaries for free, and are paying nothing for any future value creation (be it derived from organic growth or capital allocation, including M&A or share buybacks). Fear not: while this company happens to be statistically cheap (and thus something I should be examining closely given my aforementioned errors in this category), I think BH is anything but a shrinking "cigar butt," and instead is growing intrinsic value over time.

Conclusion

At the Outdoor Retailer trade show in Salt Lake City over the summer, where I spent two days doing boots on the ground proprietary research on Black Diamond and its ecosystem (including speaking with the company, customers, vendors, and competitors), a Black Diamond employee described the passion with which BD employees approach the brand: “At BD, the employees are the customers; we design and build things that we want to use.” This resonates. In the case of Maran Partners Fund, I – the portfolio manager – am the customer. My family remains the largest investor in the partnership, with the majority of our investment capital invested therein. As do the Black Diamond employees trusting their own equipment thousands of feet off of canyon floors the world over, I continue to eat my own cooking.

Our partnership continues to welcome additional like-minded partners, many of whom are fellow professional investors and business owners. We all share a focus on the long-term. The average capital commitment of limited partners exceeds three years (the most common share class remains that with the five year commitment).

Thank you for the continued opportunity to protect and grow your family’s capital alongside that of my own. Please feel free to reach out if you have questions.

Sincerely,



Dan Roller

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The top five positions of the fund as of September 30, 2017 were Clarus Corp (CLAR), Biglari Holdings (BH), Turning Point Brands (TPB, previously referred to as Company A), Undisclosed (Company B), and Cafepress (PRSS). Prices for securities discussed are closing prices as of October 20, 2017 unless otherwise noted, and are not representative of the prices paid by the fund for those securities. Positions reflected in this letter do not represent all of the positions held, purchased, and/or sold, and may represent a small percentage of holdings and/or activity.

In Q3 2017, and YTD, respectively, the total return of the S&P 500 was 4.5% and 14.2%, and the total return of the Russell 2000 was 5.7% and 10.9%. The S&P 500 and Russell 2000 are indices of US equities. They are included for information purposes only and may not be representative of the type of investments made by the fund. The fund’s investments differ materially from these indices. The fund is concentrated in a small number of positions while the indices are diversified. The fund return data provided is unaudited and subject to revision.

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MARAN CAPITAL MANAGEMENT

Turning Point Brands (TPB - \$13)

February, 2017

Market Cap: \$260mm | Enterprise Value: \$485mm

- Undiscovered, high quality consumer staples business with accelerating growth
- 50%+ returns on tangible capital
- Compelling valuation: 10x FCF and 8x EV/EBIT
- Aligned management/board: ~70% inside ownership
- I believe fair value today is \$20+, with upside to \$27-40+ over the next three years

Please see important disclosures on Page 5

CONFIDENTIAL; PLEASE DO NOT FORWARD

Turning Point Brands (TPB - \$13)

Price: \$13

Shares: 20mm

Market Cap: \$260mm

Net Debt: \$225mm

EV: \$485mm

Turning Point Brands is an off-the-radar, high quality, branded consumer goods company trading at a cheap price. It generates 50% pre-tax returns on tangible capital and trades at less than 10x FCF. The company has numerous growth avenues despite stable end markets, with opportunities to deploy capital at high expected returns. Insiders are aligned via ~70% ownership. I believe fair value today is \$20+, with upside of \$27 - \$40+ over the next three years.

TPB is a leading player in the Other Tobacco Products (“OTP”) market (defined as tobacco products other than cigarettes). TPB markets smokeless products (chewing tobacco, moist snuff), smoking products such as papers and wraps, and what the company calls “NewGen” products (E-cigarettes, vaporizers, liquids, etc). TPB’s brands include Stokers (the #2 domestic chewing tobacco brand), Beech Nut (#6 in chewing tobacco), and Zig Zag (#1 in rolling papers); several brands date to the late 1800s. TPB is the #2 player in chewing tobacco in the US, with ~28% share.

The tobacco market is principally an oligopoly comprised of rational players. While TPB is not dominant in all of its markets, its small size allows it to be nimble and seek growth in an otherwise stable market, all while enjoying a pricing umbrella provided by the industry structure.

TPB utilizes an efficient, capital light business model focused on marketing and distribution. Production is largely outsourced. The company spends a scant \$1-2mm/yr in annual capex.

Stable End Markets Belie Large Growth Runway

The domestic cigarette market is in slight structural decline, but the \$10bn OTP market is experiencing moderate growth (+5% in 2016). While TPB has seen segments of its business ebb and flow over the past few years (cigar wrappers have been a drag, for example), overall results have been incredibly consistent. It would be difficult to overstate the stability of the business: Adjusted EBITDA was \$50mm +/- \$2mm every year for the past five years.

Befitting a highly stable business, TPB was run with six turns of leverage prior to its IPO last year, which disallowed acquisitive growth. However, following the de-levering IPO, the company now has greater growth potential, both organic (penetration, pricing) and via acquisitions.

Organic Growth

While the industry has pricing power that should provide a tailwind over time, penetration is a key component of the growth story. Stoker’s moist snuff has 2.5% market share overall, but 6.8% share in stores in which it is being sold. The company notes that in-store share is highly correlated to the number

of sales calls a store receives per year. TPB has added salespeople over the last year to drive this penetration; they have incurred the upfront costs without yet seeing the benefits.

Stoker's moist snuff is among the fastest growing brands in its segment. It is worth noting that Stoker's moist snuff has 2.5% share, which compares to Stoker's chew share of 16% – there is potentially a lot of runway to grow the Stoker's moist snuff brand organically.

Acquisition Runway

This key part of the story remains misunderstood. TPB has a large runway of potential acquisitions that will likely be conducted at very attractive valuations. The OTP industry remains highly fragmented at the low end, yet an increasing regulatory burden is likely pressuring many of these smaller competitors to consider strategic alternatives. The small absolute size of these potential acquisitions likely leaves them off the radar screens of the majors. TPB is thus in the enviable position of seeking acquisitions in a market with little bidding competition on the one hand and “forced” sellers on the other.

Since the IPO last May, the company has completed two deals. One is tiny: \$2.5mm for four regional smokeless tobacco brands. The purchase price was less than 1x sales and ~4x EBITDA (before any synergies). The purchased brands have US chew market share of ~2%, despite a footprint in just 25% of the market. TPB will aim to increase their penetration via TPB's broader distribution network, much as in the Stoker's example above.

The second deal is more meaningful. They purchased a “NewGen” distribution business called VaporBeast for \$27mm. In 2015, VaporBeast generated \$6mm of operating income on \$39mm of sales, and in 2016 is on pace to generate \$7mm of operating income on over \$50mm of sales. The business is growing rapidly (revenue has grown 20%+ for years). TPB paid ~4x EBIT for this growing, asset-light, high-return business. This deal appears to be very value-enhancing before considering any synergies or the possibility of continued growth at VaporBeast (each of which are likely).

Importantly, TPB believes that these two deals are just the tip of the iceberg on the M&A front. As they highlight in their investor presentation, there is a large universe of potential targets, several of which are at least as large as VaporBeast.

Strong Management with Aligned Interests

Interests are solidly aligned among the board, management, and shareholders. The IPO was 100% primary (use of proceeds: deleveraging), with all of the sponsors rolling their equity into the public company. The controlling shareholder, Standard General (a NYC-based hedge fund), dramatically increased its holdings at the IPO, buying ~3.5mm shares outright, and rolling debt holdings into another ~4mm shares. Standard General and related entities own just under 11mm shares – 59% of the company – many of them acquired at the IPO price of \$10 per share.

Directors and executive officers as a group own ~14% of the company. The founder and chairman, Thomas Helms, owns ~9%. The CEO, Larry Wexler, owns ~3%, and even the general counsel owns ~1%.

Wexler is an industry veteran. He has been with TPB and its predecessor companies for 13 years. Prior to that, he held increasingly senior roles at Philip Morris USA, where he spent 21 years. This is a strong, tenured team with a disciplined capital allocation framework (supported by Helms, who built the company starting in 1989, and Standard General).

Valuation

I believe 10x fully-taxed FCF to the equity is cheap for a company of this quality and durability. The pre-tax earnings yield of the enterprise (EBIT/EV) of 12% is coupled with a pretax return on tangible capital (EBIT/Tangible Invested Capital) of 50%.

Large tobacco peers such as Philip Morris, Altria, and (until recently) Reynolds trade at 13-14x EBITDA and 19-22x P/E. Recent transactions in the industry have occurred at an average of 13x EBITDA (with the recent BAT/Reynolds deal occurring at >16x EBITDA).

If TPB were to trade at 19x PE or 13x EBITDA (the low end of the ranges above) it would be a \$24 – 27 stock.

While one could argue that TPB deserves a size or liquidity discount, one could also make the case that it should trade at a premium reflective of its enhanced growth potential.

If the company does nothing but de-lever, I think 2020 FCF power is \$1.75; under more aggressive M&A scenarios, I model FCF upside to as much as \$2.50/sh. It seems easy to see significant upside in the stock from the recent \$13 level over the next several years if any of these scenarios play out.

Additional Resources

TPB final IPO prospectus, form 424B4, filed on 2016-05-12 – Good background of company and industry. Five years of selected financials.

TPB 8-K/A Exhibit 99_3 dated 2017-01-20 – VaporBeast historical financials and Pro Formas.

SDOI form S-4, filed on 2017-01-30 – Standard General plans to drop ~50% of TPB shares into this NOL shell vehicle that they control. A fair value opinion is included, which values TPB at a range of \$14.66 – \$53.53.

Press Release dated 2/20/2017 regarding debt refinance.

Risks

Regulatory

Supplier concentration

Industry becomes less rational

Potential Catalysts

Debt Refinance (Completed mid-February)

Continued M&A at attractive valuations

De-levering

Tax reform – company is a full domestic corporate tax payer

Market starts paying attention

Eventual take-out by one of the majors

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