

January 28, 2019

Dear Partners and Friends,

The return of Maran Partners Fund, LP in 4Q 2018, net of all fees and expenses, was -13.3%<sup>1</sup>. For the full year 2018, the net return of the partnership was +1.7%.

2018 was a difficult year across strategies and asset classes. Notably, stocks, bonds, REITs, commodities, and gold all ended the year in the red. For the first time in memory, cash was the single best returning major asset class (returning +1.7%).

At mid-year, I stated that the first half of the year we “managed boredom,” with a net return of +3.3%. Well, the second-half performance was “just” -1.5% net. A *low volatility* positive return in a year in which the S&P 500 returned -4.4% and the Russell 2000 was down -11%? Hardly<sup>2</sup>.

While our concentrated, idiosyncratic approach has proven to have reasonably low correlation to the broader markets over time, during broad-based market sell-offs such as that experienced in the fourth quarter, it should not surprise anyone that our long-biased portfolio was not immune. Periodic drawdowns come with the territory of stock market investing in general, and especially with a concentrated strategy such as ours.

Our fund, composed of off-the-beaten path, differentiated, and special situation ideas, outperformed the market during the first nine months of the year, while the market was performing well, as well as during the fourth quarter sell-off. In fact, we have outperformed the broader markets (the S&P 500 and Russell 2000) over most timeframes, including the last one, two, and three years, as well as since inception (in some cases by just a little, and in some by quite a bit more).

But, I have cautioned before and will continue to reiterate the message: we will certainly have periods of underperformance (including thus far in 2019). Relative performance over any given short-term time horizon is not a concern; I do not manage the fund vs. any benchmark. I work hard to minimize the risk of permanent loss of capital, but frequently caution that our limited partners should expect some volatility along the way. I urge our limited partners and interested parties to plan to evaluate the fund’s performance on a risk-adjusted, absolute basis over long periods of time – that is, periods of five years or longer.

### **The Other Side of Our Trades**

The market decline in the fourth quarter left many asking *why?* What caused the sell-off? Why now? I would be wary of anyone that claims to have a certain answer to those questions. There is a set of usual suspects: rates, China’s economic slowdown, trade wars, US politics, etc. All of those factors are certainly salient, but none are new. Yet clearly, a *tipping point* was reached in the fourth quarter.

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<sup>1</sup> 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 9 for important information.

<sup>2</sup> Perhaps a reminder about the effects of myopia and loss aversion is apt. See the original Thaler et al., 1997 paper, or chapter two of my favorite overview of behavioral economics, *Why Smart People Make Big Money Mistakes & How To Correct Them*, which, despite its title, is excellent (it is the behavioral finance corollary to Greenblatt’s *You Can Be A Stock Market Genius*).

The market is a complex adaptive system in which the behavior of market participants affects those of others, in endless feedback loops. There were elements of the recent market sell-off that reminded me of the 1987 correction (with its associated *portfolio insurance*), but in slow motion this time around. At some point, it felt as if selling simply begot selling, whether driven by momentum investors, risk limits being reached, redemption requests out of funds, tax-loss selling, or psychological or other factors.

Amidst the worst of the sell-off, the *Wall Street Journal* ran an article titled *Behind the Market Swoon: The Herdlike Behavior of Computerized Trading*<sup>3</sup>. Citing a JP Morgan report highlighting the growing importance of quant funds, passive funds, index investors, and high frequency traders, the article stated, “Roughly 85% of all trading is on autopilot – controlled by machines, models, or passive investing formulas, creating an unprecedented trading herd that moves in unison and is blazingly fast.”

That statistic is astounding. And while at first it may give pause, I think it should give fundamental, bottoms-up, value-driven investors such as ourselves cause to celebrate. Ultimately, I don’t believe that Ben Graham’s formulation that, in the long run, the market is a “weighing machine” is any less true today than it was when he first penned it. I will try to continue to take advantage of the momentum algorithms and other forms of forced or uneconomic selling when appropriate.

### **Second-Order Thinking**

It is not uncommon to hear people asking if we are now in a bear market or if a recession is imminent. My question to portfolio managers asking themselves or others these questions: would you position your portfolio any differently if you knew the answer with certainty? Here at Maran Capital, I am investing as if I don’t know (and don’t particularly care) whether a recession is imminent (or indeed if we are already in one).

First of all, there are many companies that will perform well even if the ~\$20 trillion US economy shrinks slightly, or grows less rapidly for a while. Second, for stock investors, what matters is what’s priced in, and having a large margin of safety.

Howard Marks, one of the most thoughtful investment commentators writing today, titled his first book *The Most Important Thing*. This is somewhat tongue-in-cheek, as the book contains 19 chapters, each of which details a unique *most important thing*. Yes, there are obviously many significant factors that go into a sound investment process. But he opens the book with a chapter on second-order thinking, which I think gives readers a sense of his perception of its relative importance. The chapter is a mere six pages long, but it summarizes an absolutely critical point about investing. In brief: it is easy to differentiate high-quality companies from those that are less so. But good companies, because they may be richly valued, do not necessarily make good stocks. And just because the economy may slow or shrink a bit doesn’t make all stocks bad stocks. What matters is what’s priced in.

In certain stocks and certain sectors, a recession already seems to be priced in. In some cases, people seem to be engaging in “rear-view mirror” investing, with their eyes and fears firmly on the great financial crisis of 2008. This is especially true in sectors that were the most badly hurt during the last recession, including housing. My mindset is first and foremost that of a part owner of the businesses in which we are invested, and I am always looking to buy pieces of those businesses with a large margin of safety.

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<sup>3</sup> <https://www.wsj.com/articles/behind-the-market-swoon-the-herdlike-behavior-of-computerized-trading-11545785641>

Cognizant of the recent slowdown in the housing market (and indeed more broadly in the economy) but focused on second-order thinking, I have begun purchasing shares of a homebuilder at a large discount to my assessment of its intrinsic value, more on which below.

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## Portfolio Update

At year end, our top five positions were Clarus Corp (CLAR), Biglari Holdings (BH), Atento (ATTO), Radisson Hospitality (RADH.ST), and Scheid Vineyards (SVIN). Our top ten longs accounted for 92% of our long exposure, and the fund was 85.3% long by 5.4% short, bringing net exposure to 80.3% and gross exposure to 90.7%. Our core portfolio companies (special situations aside) generally have strong balance sheets, large inside ownership/are run by owner-operators, and trade at valuations that are well below my estimates of fair value.

### Clarus Corp (CLAR)

Clarus, parent company to Black Diamond Equipment and Sierra Bullets, continues to execute very well. Last week, they positively preannounced 4Q results – solid momentum continues.

I most recently laid out my thinking about Clarus in a detailed [memo](#) last summer. As a reminder, my upside case is predicated on the following:

- The business as it stands today is worth \$15/sh (midpoint of recent comparable transaction multiples)
- Black Diamond apparel business worth \$5/sh (\$150mm) over the next five years (on \$70-100mm of revenues)
- Black Diamond footwear business worth \$5/sh (\$150mm) over the next five years (on \$70-100mm of revenues)
- Sierra Bullets can create \$3/sh in value over the next five years (as mid-cycle EBITDA grows from \$12mm to \$20mm)
- FCF generation and capital allocation can add \$7/sh in value over the next five years

$$15 + 5 + 5 + 3 + 7 = \$35/sh$$

Clarus has been tracking at or better than my upside case over the past few quarters. It grew sales in the double digits organically in the second half of 2018, with the important apparel segment accelerating to 58% y/y growth in 4Q (from 40% y/y in 3Q). Margins increased throughout the year. The company continues to make savvy capital allocation decisions, including a Dutch Tender at \$8 per share last summer, continued share repurchases in December during the market volatility, and a bolt-on acquisition of a niche skincare business (SKINourishment) that is a prime example of the smart “small bets” strategy the company is pursuing. If Clarus can eventually drive \$10mm of sales in skincare by selling it through Black Diamond’s existing distribution network (at very high gross and contribution margins), the skincare segment could ultimately be valued at \$50mm (10x EBITDA), or almost \$2 per CLAR share. This for a business for which they paid a de minimis amount (under the threshold for disclosure).

I believe CLAR is still on pace to generate \$0.75+ of cash earnings this year, and \$1+ next year, putting its trading multiple at ~13x on 2019 and 10x on 2020.

Other consumer brands that are perceived to be executing well such as Lululemon (LULU), Crox (CROX), and cooler-maker YETI Holdings (YETI), which as a group are growing sales in a range of mid-single-digits to high-teens, trade at forward P/E multiples of ~20-40x. While I value Clarus on a standalone, bottoms-up basis (and not on a relative basis or just based on one simple metric), it is still worth noting that the market values some of CLAR's market "neighbors" at more than twice where Clarus trades. CLAR still flies under the radar, but eventually I believe the market will wake up to its value.

### **Biglari Holdings (BH)**

BH was a frustrating stock in 2018. My estimate of intrinsic value was relatively unchanged, yet the stock fell significantly. This is a company for which estimating intrinsic value is relatively straightforward, as it is a holding company whose value is largely comprised of cash and publicly traded securities.

In the days following its shift to a dual class structure and associated removal from S&P indices (and therefore forced selling by index investors), the B shares (ticker: BH) fell by about a third, from ~\$280/sh (adjusted for the corporate action) to between \$180 and \$200/sh. This was a classic special situation in my mind: no change in underlying value, forced/non-economic selling, and a large discount to intrinsic value (which I pegged somewhere in the low \$300s/sh on the new B shares, making the stock at the time a ~60c dollar); so I increased our position. For what it's worth, Sardar Bilgari, BH's chairman also saw value at the time and purchased \$4mm of stock personally in June at an average price of \$195 per B share equivalent.

In 4Q, the cheap got cheaper. BH fell by over a third in the fourth quarter to end the year at \$114/sh. At the same time, given the solid performance of Cracker Barrel (CBRL, up ~10% in 4Q), BH net asset value increased.

My conservative estimate of NAV/liquidation value of Biglari Holdings is \$300-330 per BH share (and \$1500-1650 per BH-A share). I believe these are conservative estimates because they are derived by placing zero value on one of the core wholly-owned subsidiaries, Steak n Shake. Thus, I believe this is now a ~40c dollar (or perhaps cheaper, depending on the value of Steak n Shake).

Another way of looking at this: every BH share has the economic ownership of roughly two Cracker Barrel shares. You can buy a BH share for ~\$126, and you get two CBRL shares, each worth ~\$168. (Cash, other investments, and the value of BH's insurance subsidiary are roughly equal to the deferred tax liability, so two times the CBRL price is a decent back-of-the-envelope proxy for BH's value, assuming you want to carry Steak n Shake equity value at zero.)

The total float of Biglari Holdings (not controlled by Biglari Capital Corp, the GP of the chairman's investment vehicle) is around \$175mm. Compare this to the \$500mm+ of CBRL that BH owns. With savvy capital allocation by the company (share buybacks at current discounts to NAV, for example), intrinsic value could increase substantially. No matter how you cut it, I think this stock is extremely cheap, and it is just a question of how long it takes for the market to realize it (or for the company to take action to realize it).

## Atento (ATTO)

Atento was another frustrating holding last year. I think intrinsic value is in the teens per share, yet over the last few months, the stock fell from ~\$8 to ~\$4 on no major change in the company's fundamentals.

I never have a single "price target" for any of my investments. While I do estimate intrinsic value of companies I study and own, I try to think probabilistically, and in ranges. I can come up with what I think are reasonable scenarios that put Atento anywhere from ~\$8/sh to ~\$25/sh over the next few years. It is very hard for me to come up with a scenario that justifies the current ~\$4 price. ATTO is trading at around 3x EBITDA on estimates of trough EBITDA, and at under 5x FCF (after maintenance capex). I think this is very far below private market value for the business. Of course, it could trade lower in the near term, but I am confident that the business is less volatile than the market seems to think it is, and that the business is worth considerably more than where shares are currently exchanging hands.

The company, controlled by a 66%+ owner who I believe to be rational and committed to a successful outcome, instituted a share buyback in the second half of last year. At current prices, share buybacks are the single best use of the company's copious FCF generation, above M&A or growth capex.

## Radisson Hospitality AB (RADH.ST) – Special Situation

As I mentioned in last quarter's letter, "there is a...situation that I am following right now in which a company will have a contractual obligation (not just a contractual right) to bid for a security, setting up an interesting short-term risk-reward situation."

The perceived positive short-term risk-reward situation was in Radisson Hospitality, which trades in Sweden. I sourced this idea from my good friend, and very smart fund manager, Brad Hathaway of Far View Capital. Brad wrote up and first shared the idea last spring and later pitched it in June at VALUEx Vail (Brad's excellent presentation can still be found on the VALUEx Vail website).

I started following and researching the company after hearing about it from Brad, but I got very excited about it when HNA, the controlling shareholder at the time, sold their controlling position to Jin Jiang (a Chinese hotel conglomerate) for 35 SEK per share, in the fourth quarter.

You see, under Swedish law, when 50%+ of a company is acquired, the acquiring company is legally required to bid for all of the remaining minority shares at or above the same price already paid. As a recent RADH press release stated, "*The completion of the acquisition triggered an obligation for the Consortium [Jin Jiang] to launch a mandatory public offer for the remaining outstanding shares in the Company.*"

When Jin Jiang closed on their transaction to purchase over 50% of RADH shares at 35 SEK, it thus became a legal requirement for them to bid for all minority shares for *at least* 35 SEK. Once this obligation was triggered, yet the stock did not seem to be placing any odds on a bid above 35, I made this a top five position in our fund. After all, at that point, downside was limited to 35 (barring very low probability events), while upside was...something. Yes, there was a decent chance that Jin Jiang might just bid 35, but there was also a chance they would bid more (say 40, or 45, or 50+) in order to induce minority stockholders to part with their shares.

This was a classic *heads we win, tails we don't lose much* investment.

Ultimately, Jin Jiang bid 40 SEK for the minority shares and later raised their bid to 42.50 (20% higher than the 35 SEK minimum bid required).

We would be lucky to find one special situation this compelling every few years, although trust me, I'm on the hunt.

### **Scheid Vineyards (SVIN)**

Scheid continues to trade at less than 40% of my estimate of fair value. While results are lumpy (both seasonally, given the annual cadence of planting, growing, and harvesting grapes, as well as year to year, as the company can store its valuable finished wine inventory and choose to sell it when optimal), I believe they continue to make progress towards building the branded wine business, which is the key to growing intrinsic value significantly beyond the ~\$200/sh at which I currently estimate it.

Recent primary research and scuttlebutt indicates the company is making inroads to selling branded wine with several new national accounts.

While Scheid produces over 2mm case equivalents of wine per year (~500k of which are sold as bottled, branded wine at this point), they also have a small 8k-case premium wine brand (under the namesake "Scheid Vineyards"). Dorothy Gaiter and John Brecher, former long-time wine writers for the *Wall Street Journal*, recently wrote a great article about this small (but growing) brand. You can read it [here](#).

### **Beyond the Top Five Positions**

While we remain concentrated, I have been more active in the portfolio of late, trimming some positions that were closer to my estimates of fair value in order to buy stocks that were trading at much wider discounts. Market volatility is a positive when it creates opportunities to do this. Several larger companies dipped to levels in late 4Q that made them attractive risk-rewards. I established a new position in a \$5bn+ company during the fourth quarter. I have also continued to add to a sub-\$100mm company that I have been nibbling away at over the last few quarters.

Additionally, as I mentioned above, I established a new position in a homebuilder.

### **Century Communities (CCS)**

Careful readers of these letters may recall that we purchased a number of land- and homebuilding-related companies in 1Q 2016. One of those companies was UCP, whose parent company, PICO, was under activist pressure to simplify its portfolio. PICO did eventually simplify, selling UCP to Denver-based homebuilder Century Communities in mid-2017. This put CCS on my radar screen. I followed CCS over the ensuing years, came to respect the management team and strategy of the company, and finally was offered what I believe was a compelling valuation on the company by the market.

Century is run by two brothers, Dale and Robert Francescon, who previously built another homebuilder before selling it to DR Horton in 1996. They founded CCS in 2002 and took it public in the summer of 2014 at \$23/sh. The Francescon brothers together own 13.4% of the company, and they run it like owners. The company has grown its book value *per share* from \$16 in 2014 to over \$27 at last check. Yes, despite nearly doubling book value per share in the last five years, the stock is trading below the 2014 IPO price (and at around three quarters of book value).

I believe the company is well-positioned, targeting lower-priced, entry-level homebuyers in strong markets. I have been impressed by the company's capital allocation. They recently acquired an asset-light, entry-level homebuilder called Wade Journey Homes, which should help drive growth, despite some recent softening in parts of the US housing market.

Wade Journey is a (still hidden, I think) gem of a business. It is asset-light, high-return (over 40% pre-tax ROE), high-growth, and solely focused on entry-level homebuyers, with an average selling price of ~\$150k/home.

CCS acquired 50% of Wade Journey in 4Q 2016 for \$17mm and then purchased the remaining 50% in 2Q 2018 for \$38mm (bringing total consideration for the business to \$55mm). Wade Journey is running at around 2k closings per year, which, at an ASP of \$150k/home and an assumed 10% pre-tax margin, equates to ~\$30mm of contribution (in 3Q alone, Wade Journey did over \$10mm of pre-tax income). It appears CCS paid just over two times fully-taxed earnings for this business.

Wade Journey has grown from less than \$20mm of sales in 2013 to over \$250mm in 2017 (1700 homes at ~\$150k/home) while focusing on just a handful of markets in the southeast (Georgia, Florida, and the Carolinas). CCS is expanding the Wade Journey asset-light model into new states (Texas, Arizona, Indiana, and Ohio), so growth should continue. This business, purchased for \$55mm, could be doing over \$500mm of revenues and \$40mm of earnings in a few years. At a 10x multiple, the business would be worth \$400mm (over 7x what CCS paid for it), or \$13 per CCS share. This is for a small piece of CCS to which the market doesn't seem to be ascribing much value right now.

The macro backdrop has weakened, and homebuilder margins are likely to be under some pressure in the near term. Wall Street consensus estimates may be too high. But I believe that at recent valuations this could be a three-year double, while the risk of permanent capital loss is low. This is still a moderate-sized position, as one can always hope that a "miss" or reduction of Wall Street estimates could lead to an even better entry point, but I am happy to own this company right now with a multi-year horizon. CCS management seems to agree: they recently implemented a sizeable share repurchase authorization (of over 10% of shares outstanding).

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### **Operations Update**

Preparations for the 2018 audit and tax return are underway. K1s should, as in years past, be available in mid-March – we don't want to be the sole cause of your having to file for an extension.

As has been the case since fund inception, the General Partner will continue to reimburse the fund for the majority of fund operating expenses, the largest of which are fund administration and tax/audit expenses. 2019 partnership expenses (excluding trading commissions) paid by the partnership will be capped at 0.5% (50 bps) of total capital.

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## Conclusion

My wife, Dwyer, and I celebrated our 10<sup>th</sup> anniversary in December by getting away from it all for a few days in Costa Rica. We decompressed and reconnected, relaxed, and read a lot.

One of the books we read on our trip was *Silence in the Age of Noise*, by Norwegian explorer Erling Kagge. Kagge has climbed Everest and trekked to both the North and South Poles – the latter, alone. When he set out for the South Pole, a journey that would take him 50 days, the first thing he did was take the batteries out of his emergency radio. He would do the walk not only unsupported, but in a certain kind of silence: sans contact with the outside world.

His book is a series of meditations and reflections on silence (and purpose, and joy, and true luxury, and boredom, and much more). Noise, both literal and proverbial, surrounds us. From traffic, to the nightly news, to social media, to the opinions of people we've never met, to the minute-by-minute fluctuations in stock prices, it can be easy to get swept up by noise. I'm not going to recommend that anyone start meditating (although Bill Gates recently [did!](#)), but the book is a nice reminder to tune out the pervasive noise, whatever that means to you. Remember, the opposite of noise can be silence, but it can also be "signal."

I am approaching the start of 2019 rested, focused, and very excited about the current opportunity set in the markets. I have commenced the year by adding to positions – some new, some long-held – that appear compelling. I believe our portfolio is well-positioned for the coming years, and I continue to have the vast majority of my personal and family capital invested in the fund alongside yours.

Thank you to all of the partners who have joined me on this journey of protecting and compounding our wealth. Please don't hesitate to reach out if you have any questions about any aspect of the partnership.

Sincerely,



Dan Roller



## Disclaimer

This document is not an offer to sell or a solicitation to buy any interests in any fund managed by Maran Capital Management, LLC (“MCM”). Any such offering will be made only in accordance with the Fund’s Confidential Offering Memorandum (the “Offering Memorandum”). The Fund may not be eligible for sale in some states or countries, nor suitable for all types of investors.

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. Performance returns are estimated pending the year-end audit.

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.

Certain information contained in this document constitutes “forward-looking statements,” which can be identified by the use of forward-looking terminology such as “may,” “will,” “should,” “expect,” “anticipate,” “target,” “intend,” “continue” or “believe,” or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results or the actual performance of the Partnership described herein may differ materially from those reflected or contemplated in such forward-looking statements.

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Prices for securities discussed are closing prices as of January 25, 2018 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 Q4 2018, the total return of the S&P 500 was -13.5%, and the total return of the Russell 2000 was -20.2%. In 2018, the total return of the S&P500 was -4.4%, and the total return of the Russell 2000 was -11.0%. 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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