July 21, 2020

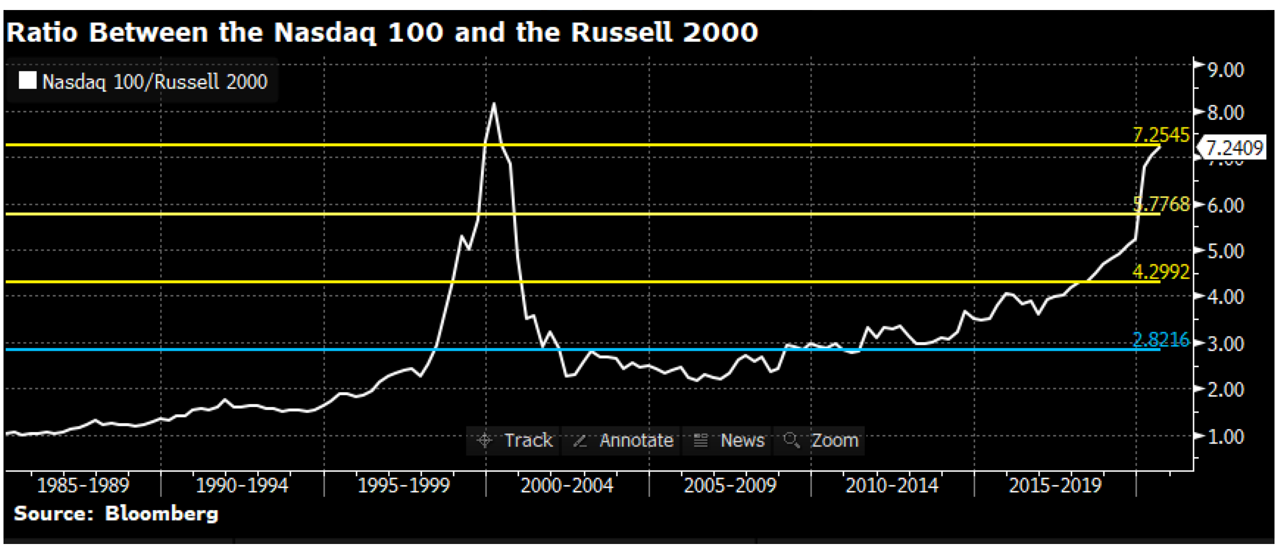
Dear Partners and Friends,

Maran Partners Fund returned +5.4% in the second quarter, net of all fees and expenses, which brings its year-to-date return through June to -13.1% net.[1] Performance has continued to improve in July, and as this letter goes to press, the fund is down mid-single digits year-to-date.[2] As always, during good times and bad I remind our partners that we are focused on long-term performance. Over the past three years, Maran Partners Fund is up +28% net while the Russell 2000 total return index is up just +6% during the same period, and we are ahead of that index over five years and since inception as well.[3]

The worst of the Covid fears have subsided, but the virus is not yet behind us. The first derivative of economic activity is once again positive – trends are improving off the low base reached in March and April – but the absolute levels of economic activity and employment are still far below where they were a year ago. The economy is still in a severe recession, and I believe it will be at least several years before GDP and employment regain their 2019 levels.

As crazy at it sounds, speculative mania has gripped pockets of the market (the fervor around certain cult stocks is reminiscent of 1999), while other pockets have been left for dead (as was the case with small-cap value at the turn of the millennium). We can safely ignore the former (participating in speculative manias is just not our game), but the latter is a source of opportunity.

Bloomberg recently published this chart of the ratio between the tech and large-cap-heavy Nasdaq 100 index and the small-cap Russell 2000 index. It is approaching prior peak (1999/2000) levels.



[1] Individual partner returns may vary based on fee structure and timing of investments. Please see disclaimer on page 6 for important information.
[2] Estimated performance through July 17, 2020, net of all fees and expenses.
[3] Through June 30, 2020.

I don't have an opinion as to how long this trend will continue. I am just sticking to my knitting and looking off the beaten path for quality businesses at attractive prices. Regardless of the market backdrop – panic or euphoria (each of which we have seen in various stocks and sectors in the last six months alone) – I remain dedicated to my process of deep research, fundamental analysis, and conservative underwriting.

There are many wonderful businesses in the smaller-cap world that meet our criteria. We own a number of businesses trading at double-digit free-cash-flow yields with minimal reinvestment needs that I believe can compound earnings at double-digit rates for years to come. We even own some high-quality technology companies that are growing rapidly; they are just generally in special situations such that the market is not making us pay up for them.

Portfolio Update

At the end of the quarter, our top five positions were, in alphabetical order, Clarus (CLAR), IAC/InterActiveCorp (IAC), Scott's Liquid Gold (SLGD), Turning Point Brands (TPB), and one position that remains undisclosed. Our top 10 long positions accounted for 83% of our long exposure at quarter-end, and we only had two short positions (both related to our IAC special-situation trade, more on which below).

Special situations have been our best risk-adjusted use of capital. They have been both sources of shorter-term trades with catalysts and ways to enter longer-term positions at favorable valuations. In the case of IAC and TPB, special situations created short-term catalysts and, more importantly, attractive entry points into great companies that we would like to own for the long term.

IAC/InterActiveCorp (IAC)

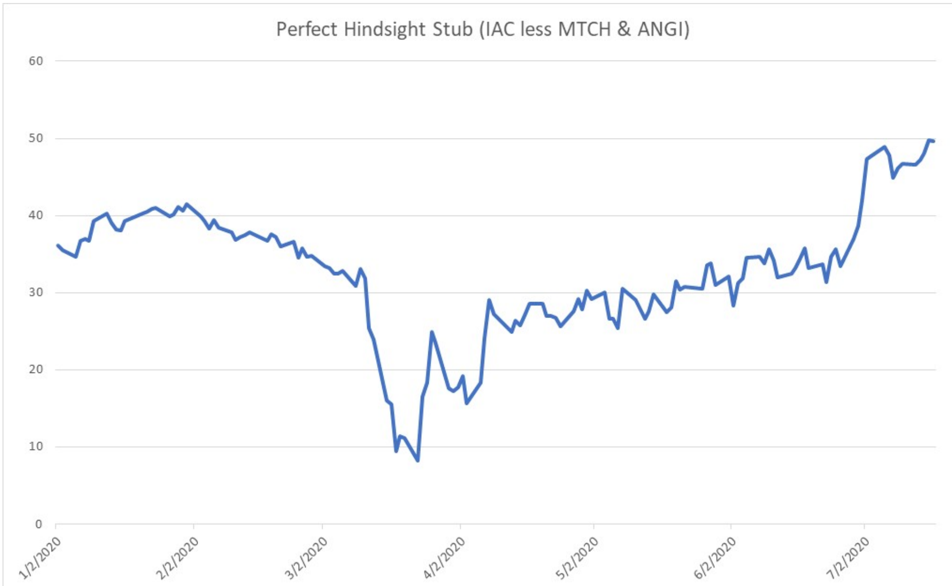
IAC is the internet conglomerate chaired by Barry Diller. Over the years, it has nurtured and spun off such stalwart properties as Expedia, LendingTree, Ticketmaster, and Match.com. IAC has always utilized a holding company structure, comprised of both controlling stakes in public companies and fully owned businesses. Despite a great track record of capital allocation and organic growth, IAC has at times traded at wide discounts to not only conservative estimates of its net asset value (NAV) but also to the value of its public securities portfolio alone.

I have followed the company closely for years, and in early 2018 implemented a special-situation position in the IAC "stub" – that is, we were long IAC and short both Match.com (MTCH) and Angie's List (ANGI) at the ratio in which IAC owned them. There was no catalyst at the time, but as I wrote in our 1Q 2018 letter to partners, I felt that we were buying $15-20/sh of net assets for *negative* $28/sh (IAC traded for around $162/sh, while its MTCH position was worth $122/sh and its ANGI position was worth $68/sh).

Two years later, the market once again provided what I thought was an attractive opportunity to set up the IAC "stub" trade – this time with a firm catalyst in place! IAC had announced that they were planning to spin off MTCH during 2Q 2020 (and "spin" doesn't quite do the transaction justice – it was a fairly complicated set of maneuvers that required significant study to fully understand). Prior to the spin of MTCH, IAC had a ~$25bn market cap. The MTCH position accounted for perhaps ~$21bn of value, ANGI another ~$5bn or so, and fully owned businesses another couple billion. It was a "90 cent dollar" at best – not that interesting on the surface.

But following the MTCH spin, IAC would become a leaner, more focused, very cash-rich mid-cap company, at a larger discount to NAV. I thought that it had a good chance of re-rating higher as analysts and investors focused on it.

There were various moving parts to the transaction right up until the end, but this chart shows the "perfect hindsight" IAC stub value year-to-date (given the ratios ultimately announced at deal close).



It is worth noting that IAC, following the transaction (which closed on June 30th), has approximately $46/sh in cash. Net of the ANGI position and this cash, the new stub enterprise value (IAC less ANGI and less net cash) is still trading very close to $0/sh (the market cap is currently around ~$10.7bn against ~$6.4b of ANGI, ~$4bn of cash, and wholly owned companies that I value, net of capitalized corporate expense, at $2bn+).

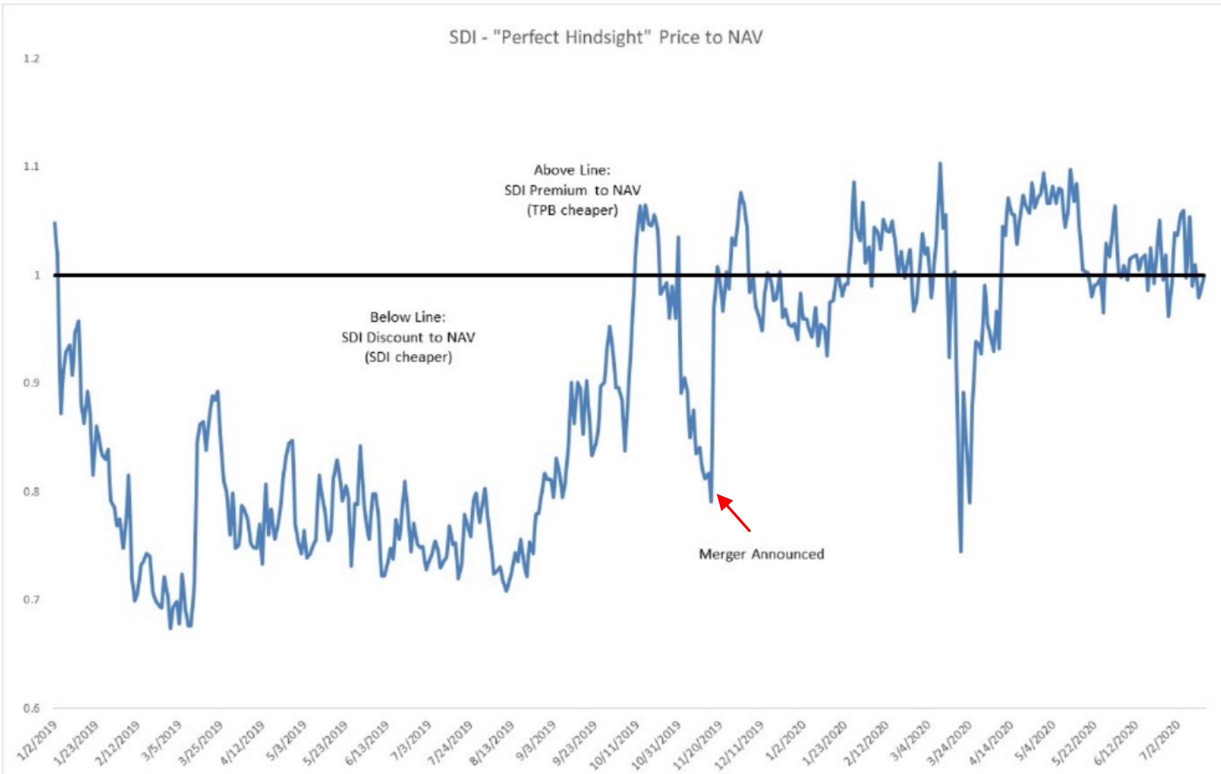
I believe investors will spend more time focusing on the fully owned businesses at the new IAC. These include Vimeo (online video), Dotdash (online content), Care.com (online childcare marketplace), and many other smaller digital businesses. Looking forward, I believe that many of these businesses will continue to grow in value, and that the discount to NAV at which IAC trades will continue to narrow either organically, due to share buybacks or other smart capital allocation, or due to the eventual spin off of ANGI or IPO of Vimeo.

Turning Point Brands (TPB)

Turning Point Brands is once again a core top-five position in the fund. We previously owned TPB from 1Q 2017 through October 2018, exiting only when it reached our estimate of fair value at that time. We revisited the company and its parent, Standard Diversified, over the last eight months, following reductions in the share prices of each, continued growth in the fair value of TPB, and, importantly, the announcement that the two would merge (which I believed would simplify the structure, increase liquidity, and reduce a perceived overhang).

Our path to a core, unhedged, net long position in TPB was somewhat circuitous. There have been times since last November at which we were taking advantage of what I called the "parent-daughter arbitrage" opportunity between SDI and TPB, and therefore owned one or the other, depending on which was cheaper (considering they essentially constituted economic ownership in the same underlying business).

I laid out my case in my last two partner letters as to why I thought the TPB/SDI merger had a high certainty of closing (and therefore the risk of the arbitrage was small). As the following chart illustrates,[4] there have been meaningful opportunities on both sides of this trade at various points in time since the transaction was announced last November.



The merger was successfully completed in mid-July, leaving behind a cleaned-up structure, no controlling shareholder, a lower TPB share count, greater liquidity, and a significant amount of momentum in the underlying business.

We first invested in Turning Point Brands (TPB) shortly after its IPO. At the time, I underwrote the business at around $13/sh, based on ~$1.30/sh of FCF. I liked the idea of paying just 10x free cash flow for a business with both a very stable core and significant growth potential.

We once again own the business at a single-digit multiple of free cash flow, and the growth prospects of the business are just as good, if not better, than they were three years ago. Turning Point Brands is asset-light, has high returns on capital, and has a stable core with numerous organic and inorganic growth opportunities.

[4] I call this the "Perfect Hindsight" chart because it applies the final ratio that SDI shareholders received which was only disclosed upon the completion of the merger. There were times along the way when many estimates were required to estimate SDI's NAV and therefore the attractiveness of the arbitrage.

I believe the noise of the merger with SDI overshadowed some of the positive developments at TPB over the past few months, including an accretive acquisition (a low-risk $7mm of EBITDA purchased for $46mm) and significant acceleration in the business in 2Q. As part of the transaction with SDI, TPB "repurchased" ~1.5% of their shares for $0. Now that the transaction is complete, I believe that investors may take a fresh look at TPB and like what they see.

Conclusion

I was recently asked by a potential investor in the fund about some of my influences as an investor and whether there was a defining realization that helped crystalize my style or approach. I answered by describing a company that I started following as an intern and whose success I watched unfold in the subsequent years (leading up to its sale in 2007).

I have written about this story in prior letters and used it as a case study in a presentation I gave on Clarus in 2018. The company is Armor Holdings. With Warren Kanders (now CEO of Clarus) at the helm, Armor Holdings grew its stock value from ~$0.75/sh to $88/sh in 12 years (a 100+ bagger, and 49% CAGR, for those keeping score at home).

This was not a sexy technology or internet business. The company was never a household name. It generally traded at a low double-digit P/E multiple. But with a dedicated owner-operator, a "buy-and-build" strategy, savvy deal-making, and some secular tailwinds, the result was incredible.

The lesson? We don't have to pay nosebleed valuations for the handful of large companies that dominate the major stock indices. We don't have to pay 10x or 20x or 30x *revenues* for hot software-as-a-service stocks. If we align with the right owner-operators executing the right playbooks, pay a cheap price, and have a secular tailwind at our backs (and perhaps throw in a dash of luck), fantastic results are obtainable – even in seemingly mundane industries.

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I hope that you and your families are staying healthy and safe. I am working hard, as always, to protect and grow our capital. Small cap and "value" may be out of favor, but I believe that this trend has created opportunities to buy fantastic companies at cheap prices and to ultimately compound wealth over the coming years. Quality matters, and valuation matters – I insist on both. The majority of my family's wealth continues to be invested in the fund alongside yours, and I am confident about our portfolio and prospects. Thank you for your continued trust.

Sincerely,

Dan Roller

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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.

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In 2Q 2020, the total return of the S&P 500 was +20.5%, and the total return of the Russell 2000 was +25.4%. Year to date, the total return of the S&P 500 was -3.1% and the total return of the Russell 2000 was -13.0%. The S&P 500, Russell 2000, and Nasdaq 100 are indices of US equities. They are included for information purposes only and are not 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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