Oct 28, 2022

Dear Partners and Friends,

In the third quarter of 2022, Maran Partners Fund returned -0.2%, net of all fees and expenses, bringing year-to-date performance to -25.4%.[1] This has been a challenging year in the markets, and while I am disappointed with our performance this year, I believe we are still in a place from which we can recover and produce acceptable long-term performance (and I have high standards when it comes to the definition of acceptable). This is especially true in light of the fact that current sentiment is terrible and valuations are cheap. Many stocks are pricing in a draconian scenario, but the world is not coming to an end.

That our year-to-date performance is similar to the broader indices is only accidental. Our partnership makes no effort to track the market. I aim for high, risk-adjusted, absolute returns over the long term, and I believe that if I achieve these results, then outperforming the market will be a side effect. Volatility is a trade-off that we make in our quest for superior performance.

It will come as no surprise that I continue to believe that one year is too short of a time period over which to judge the results of investment funds. Over the past five years, our partnership has compounded at a rate of approximately 13%, net.[2] In other words, over the past five years, the value of $1.0 million invested in the partnership has grown to more than $1.8 million, net of all fees and expenses. Conversely, over the past five years, $1.0 million invested in the iShares Russell 2000 ETF (IWM), a low-cost ETF that aims to track the performance of the popular Russell 2000 small cap index, has grown to less than $1.2 million.

While many have thrown in the towel on value investing, I still believe it is the most rational strategy (who wants to knowingly overpay for things?!)—especially in catalyst-laden special situations in less efficient parts of the market. My favored hunting ground of smaller-capitalization stocks seems like an especially attractive corner of the market right now.

I am finding many solid, yet under-the-radar companies trading at single-digit free cash flow multiples that I believe have long, double-digit growth runways. They don't need multiple expansion to produce mid-20s compounded returns, and to therefore be potential three-year doubles. If sentiment turns and multiples expand, some could double faster than that.

As always, there is a laundry list of macroeconomic worries that is capturing a lot of attention, including inflation, the Fed, interest rates, China, Russia, the U.S. consumer, gasoline prices, European power prices, and more. Near-term earnings estimates are still too high for many companies. The dichotomy between poor sentiment and cheap valuations on the one hand and some very real economic concerns on the other hand has made for a challenging decision-making environment.

[1] Individual partner returns may vary based on share class and timing of investment, among other factors. Please refer to individual account statements for more detail. Please see page 6 for important disclaimers.
[2] All performance results discussed are net of fees for our highest fee share class; results have been better for partners in the reduced fee share classes.

In the face of uncertainty, I continue to return to my philosophy, framework, and process. Throughout 2022, I have continued to focus on doing good research, I have remained disciplined with respect to valuation, and I have stayed humble in light of a challenging backdrop.

After running with reduced net exposure for the majority of the third quarter (our cash balance exceeded 40% following our Clarus sales during mid-August—more on which below), I have recently been adding additional exposure to a number of (smaller cap, value) stocks that I think are priced attractively despite the weak macroeconomic outlook (all of those worries). As usual, I continue to focus on special situations, stocks with catalysts, and companies for which I think I have a differentiated viewpoint about what is priced in.

My conversations with companies over the past months indicate that many are not seeing developments that justify some of the carnage we have seen in their stock prices. Currently, there seems to be a disconnect. Either fundamentals are going to get dramatically worse for many companies, or many stocks are too cheap. I believe it is among the best times in recent years to be investing with a multi-year horizon.

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Portfolio Update

At quarter-end, our top five positions were API Group (APG), Cadre Holdings (CDRE), Clarus (CLAR), Correios de Portugal (Euronext Lisbon: CTT), and an undisclosed position.[3]

Clarus (CLAR)

Clarus has been a long-time top-five position, so it may seem from the outside like the holding is on autopilot. It is not. I frequently re-underwrite all of our positions as new information comes in and as stock prices change. Clarus is no exception.

For Clarus, a lot of new information came in during the third quarter—though much of it non-fundamental—and the stock price also changed a lot, in both directions. Clarus entered the third quarter at approximately $19/sh, increased to a high of $29/sh, and later fell as low as $12/sh. It increased by 50%+ then declined by 50%+, all in a few months.

While I generally invest with a long horizon and try to be patient when warranted, I am also pragmatic. Our fund's smaller size allows me to be nimble when warranted.

Given the speed and magnitude of Clarus' increase during mid-August, accompanied by a lack of substantive change in the fundamentals, I attributed Clarus' rise to non-fundamental factors[4], and took

[3] Listed alphabetically.
[4] Likely a short-squeeze or gamma squeeze, as a number of hedge funds started wildly trading Clarus options and stock during the quarter (options volume exploded more than 100-fold); at one point, three funds collectively had long exposure to almost 50% of Clarus' shares.

advantage of the stock's move higher to trim our position meaningfully. By August 19th, we owned the fewest number of shares that we had owned in years.

Recently, we took advantage of volatility in the other direction, adding back to our position at less than half the price at which we had sold just weeks prior.

Clarus is certainly facing several headwinds—including a promotional retail environment, a weak euro and Australian dollar, and weakness in new car volumes (which impacts its Rhino Rack business)—but I don't believe that these headwinds justify the current stock price.

Clarus' enterprise value is around $600 million. If Rhino Rack is worth around $200 million (about 8x EBITDA) and Sierra/Barnes is worth around $200 million (5x EBITDA), the market is implying that the Black Diamond Equipment brand is worth just $200 million (under 0.8x sales and ~6x EBITDA). Another way of framing valuation is that the market is paying a reasonable price for Black Diamond and Rhino Rack and that we are getting Sierra and Barnes for free.

In aggregate, Clarus is trading at around 7.5x EBITDA and at a double-digit normalized cash earnings yield. Given the valuation, the quality of the Clarus brands, the long-term growth outlook, the aligned management team, the recent insider purchases, the share repurchase authorization, the partly non-fundamental set of events that led to the sell-off, and the continued high short interest (eight million shares, or almost one third of the float, at last check), I believe this is an attractive situation.

API Group (APG)

We have owned API Group shares for over two years, having initially purchased our position during the first half of 2020 (during Covid). Recent additional purchases moved it into our top five positions.

API Group is a holding company for a group of safety, engineering, and industrial services businesses operating globally, with roots dating back to 1926. The company is a market leader in a number of niche industries (fire safety, specialty contracting) and in many countries in which it operates. It has significant recurring revenue and is capital light. I believe that API's management are good operators and capital allocators.

API Group had an interesting path to being a publicly traded US stock. Its life began as a UK-domiciled special purpose acquisition company (SPAC). Following the de-SPACing merger, shares were de-listed in the UK and began to trade on the OTC Marketplace "pink sheets" in the US. Combine this non-standard path to market, non-standard trading marketplace, and the Covid-related market decline, and it should come as no surprise that APG "broke" its listing price, ultimately trading as low as the mid-single digits.

This was a unique special situation set-up, and while I didn't take a huge position, I started buying shares at this point, while the market cap was around $900 million (the ticker at the time was JJAQF).

The shares were up-listed to the NYSE in May 2020; by the end of 2021, they had climbed to north of $25 per share. I shrank the position size as the stock climbed, bringing it to 3% of capital at year-end 2021. By the end of the third quarter of this year, the stock had fallen by almost half from its highs, and I started adding again.

In the mid-teens, API Group's market cap is just north of $3.5 billion. Looking out several years, EBITDA should grow from $600-700 million to close to $1 billion (driven by organic growth and margin expansion), and net debt should fall to around $2 billion. Bulls might argue the business—based on comparable transactions and business quality—should trade at an 18-20x multiple, but even if the stock only garners a lower 10-13x multiple, it could still be a double or a triple ($35-45/sh).

Correios de Portugal, S.A. (Euronext Lisbon: CTT)

I laid out the thesis on CTT in more depth in recent letters, but here is a quick recap. CTT's market cap is €430 million, and its enterprise value is around €500 million. The company is on track to generate more than €120 million of EBITDA this year, putting its valuation at around 4x EBITDA. It owns a bank, with book value of over €200 million, and real estate conservatively worth another €200 million. The company plans to monetize both of these assets—the bank likely via an external investment followed by a spin, and the real estate with private equity partners via a fund structure. I expect an update on both fronts in the upcoming quarterly investor report.

The stock is attractive even without the potential catalyst of unlocking the sum-of-the-parts value. CTT is the monopoly postal carrier in Portugal, with a new government contract that allows for inflation pass-through. E-commerce penetration in Portugal lags that of Spain and the rest of northern Europe but is catching up. These factors should mute any European-wide economic weakness.

At its analyst day earlier this year, CTT guided to 2025 EBITDA of €160 million to €180 million based on annual 7-10% revenue growth. The market does not believe this guidance—it is not even close to being priced in. In fact, while I think the company has a sound rationale for its guidance, it is currently priced for revenue declines.

Finally, CTT has been buying back stock aggressively. Its share count is down from 150 million shares to 143.5 million shares. If the stock remains this cheap (again, the market is valuing the core business for essentially nothing after giving credit to the bank and real estate), the company will likely continue to take advantage of market sentiment by continuing to buy back shares.

Beyond the Top Five

We have recently added a few new positions.

- A specialty industrial distributor (market cap: $500-750 million) that was formed via a three-way merger that has yet to showcase the benefits of the combination. The stock remains relatively unknown, and it trades at a large discount to peers and at a cheap absolute valuation (a solidly double-digit free cash flow yield).
- An energy services company (think "picks and shovels" for the energy industry, market cap: $200-400 million) that is trading at under three times my estimate of 2023 free cash flow. It has de-levered significantly and is about to turn on share buybacks.
- A financial services company (market cap $750 million-$1 billion) with a history of growth and shareholder value creation whose stock is pricing in a severe recession.

I'm working on an interesting event-driven special situation as well. I never know when these types of situations are going to emerge, but these have tended to be among the best sources of risk-adjusted return for the partnership.

Again, I'm excited by what I'm coming across in my favored hunting grounds (though as always, I have no idea what the market may do in the short term).

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Conclusion

You and your fellow limited partners have continued to be a major competitive advantage for our fund. This year, our partnership has had no redemptions and a steady stream of capital additions—new partners joining and existing partners dollar-cost averaging additional capital during the period of market weakness. The fact that I don't have to sell positions to raise capital (or even field panicked calls) enables me to continue to stay level-headed and execute my strategy during periods of volatility. Thank you.

I continue to have the majority of my family's investment capital invested in the fund alongside yours. I am working diligently to protect it and grow it.

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, including detailed fund performance report, will be provided upon request.

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Prices for securities discussed are closing prices as of October 28, 2022 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 3Q 2022, the total return of the S&P 500 was -5.3%, and the total return of the Russell 2000 was –2.5%. Year-to-date through September 30, 2022, the total return of the S&P500 was -24.8%, and the total return of the Russell 2000 was -25.9%. The S&P 500 and Russell 2000 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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