

April 23, 2018

Dear Partners and Friends,

The return of Maran Partners Fund, LP in 1Q 2018, net of all fees and expenses, was -2.2%¹. As I promise in essentially every quarterly letter, the partnership will have down quarters as well as up. Following six quarters in which the partnership was up (including a +10.5% net return last quarter), this was a down one. I take no pride in the ratio of up quarters to down – my core focus is the long-term compounded return of the partnership.

I welcome the recent increased volatility of the market. As I have previously written, I would rather live in a world with 80% annual peak-to-trough price swings than 20% swings. The daily, monthly, and quarterly marks in such a world might be painful for those looking at their statements frequently, but the opportunity provided (that is – to buy or add to companies during the down swings) would more than make up for the short-term pain of seeing negative numbers on a few statements. Of course, a patient and long-term horizon (with a capital base to match) are requisite to benefit from volatility.

In my last letter, I referred to a presentation that I gave on Clarus Corp (CLAR), our largest position (for reference, it can be found [here](#)). I opened the presentation with a case study on Armor Holdings (Armor was the prior public vehicle of Warren Kanders, the current chairman of Clarus, which is why it is of interest). Armor's returns were off-the-charts good – a 100+ fold return in around 12 years (I think CLAR has some similarities to Armor, but don't expect those returns to be repeated). On the path to becoming a 100+ bagger, investors in Armor lived through some gut-wrenching volatility. The worst peak-to-trough drawdown was 68%, but there were separate drawdowns of 43%, 33%, and 23% along the way. At one point, the stock traded below its prior high for almost two years.

Investors who were patient enough to sit through volatility and manage boredom (and, of course, who were *correct* in their evaluation of Armor as a compounder) were well-rewarded. I try to live these values: patience, decisiveness, a long-term horizon, and of course the analytical rigor and intellectual honesty required to derive conviction in being *correct* in my analyses (and to determine when I'm wrong, and act as necessary in such situations).

My concentrated approach means I add new core positions infrequently. Speaking of managing boredom, my letters discussing Clarus, Turning Point Brands, and a few other long-term positions may sound like a broken record. Of course, this endeavor is not a competition about coming up with the most investment ideas; only in generating superior long-term risk-adjusted returns. Heck, one good idea per decade can lead to fortunes.

The fact that I write these missives quarterly may not help maintain our focus on the long term (although I hope you find them helpful). A thought experiment may be instructive as means of shifting focus to the distant future. Think of our core positions as *subsidiaries* and our fund as a *holding company*. Through this lens, we might focus much more on the business performance of the companies we own, rather than on the quarterly *squiggles* in their stock prices. We may own just small minority positions in our companies, but I do very much consider us just that – *owners* of them. This is true for most of our core

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 refer to your statements. Please see disclaimer on page 7 for important information.

holdings (I say *most*, because I will also engage in shorter-term trades that arise around a special situation – an arbitrage, for example, or something with a very specific catalyst).

Fear not – I am well-read in the behavioral finance literature regarding status quo bias (change can be hard), the endowment effect (the tendency to overvalue that which one already owns), and bias from commitment and consistency tendency (as Charlie Munger said, “what people are shouting out they are pounding in”), among other psychological traps and tendencies. I don’t view our core positions as “one-decision” stocks (that one buys and holds forever). I’m not wedded to any position, and I constantly work to re-evaluate our positions in light of new information and changing market prices. Every day is a decision day (to buy, sell, or do nothing) for each of our positions. But when business fundamentals are improving and valuations remain depressed, I’m willing to sit on my hands.

Granny Style

Clifford Asness and Aaron Brown, of AQR Capital Management, recently published a paper called “Pulling the Goalie: Hockey and Investment Implications.”²³ In it, they conclude that the optimal time in a hockey game to pull the goalie is much earlier than is commonly practiced. When down by one goal, they find that the optimal time to pull the goalie is with 5:40 remaining. Conventional wisdom would instead have goalies pulled with around one or two minutes remaining. “When down by two goals, it pays to pull the goalie with 11:40 to go,” they find. And if a hockey team is ever down by five goals, the optimal strategy is to pull the goalie immediately, even if it’s in the middle of the second period! Despite the likely enhanced efficacy of following these strategies, they are simply not practiced. To do so would be *not prudent*.

Embracing sub-optimal strategy in sports is not limited to hockey. As Asness and Brown point out, “basketball coaches were slow to have players shoot enough three point shots; football coaches don’t go for it on fourth down nearly enough, nor attempt enough two point conversions; and baseball managers were very slow to appreciate the value of walks, the cost of outs, and the utility of the excruciatingly annoying radical infield shift.” There are a number of parallels to sub-optimal decision-making in investing, which I’ll come back to.

But first, no discussion of sub-optimal strategy in sports would be complete without a discussion of the best method with which to shoot free throws in basketball.

Rick Barry dominated professional basketball in the late ‘60s and ‘70s. The list of accolades associated with his career is lengthy: Rookie of the Year, NBA Scoring Champion, NBA Champion, NBA Finals MVP, All-Star...the list goes on. But the statistic for which Barry is best known is this: until his retirement in 1980, he was the best free throw shooter in NBA history (he still ranks in the top 10 all time).

² Asness, Clifford S. and Brown, Aaron, Pulling the Goalie: Hockey and Investment Implications (March 1, 2018). Available at SSRN: <https://ssrn.com/abstract=3132563>

³ For those non-sports fans among us, in hockey, “pulling the goalie” refers to the act of removing the goalie from the game and replacing him with another attacker, creating a 6 vs. 5 situation, and slightly increasing the odds for the team that is behind to score. Of course, it leaves the net empty and also makes it easier for the team that is ahead to score. It is basically a last-ditch effort for the team that is behind to catch up, even if it means losing by more points in many cases (but importantly, losing 3 to 1 is the same as losing 2 to 1 – that is, still a loss).

Was Barry genetically gifted? Did he practice more than everyone that preceded him? You can't chalk up his success to these factors. Instead, he simply figured out a better way to shoot free throws, and then executed. But it sure was idiosyncratic. He shot his free throws underhanded – “granny style.”

Standing out from the crowd is hard, even when it is clear that the different way is the better way. Barry relates being called a sissy, and I'm sure much worse⁴. One article from the '80s quotes a former teammate: “Around the league, they thought of [Barry] as the most arrogant guy ever. Half the players disliked Rick, the other half hated him.”

Wilt Chamberlain once shot free throws underhanded for a season, including the game in which he single-handedly scored 100 points (“the greatest game of basketball anyone has ever played,” as Malcolm Gladwell called it in his podcast on Barry). Chamberlain knew it worked, but even he didn't stick with it. “I felt silly, like a sissy, shooting underhanded. I know I was wrong. I know some of the best foul shooters in history shot that way. Even now the best one in the NBA, Rick Barry, shoots underhanded. I just couldn't do it.”

Shaquille O'Neal, a star center but middling free throw shooter, was even more direct. Barry recounts a conversation he had with Shaq on the topic: “I tried to get [Shaq] to do it and he said, ‘forget it, I'd rather shoot zero than shoot underhanded.’”

Any basketball players shooting less than, say, 75% or 80% from the free throw line (perhaps even higher), should be following in the footsteps of Barry and shooting free throws underhanded. Barry may have had to endure ridicule, but his method made him one of the best free throw shooters of all time.

It is exactly this fear – ridicule – that likely keeps coaches and players making the same sub-optimal decisions year after year.

Asness and Brown reference the obligatory Keynes quote on this topic in their paper: “Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.” They go on: “this applies to both coaching sports and portfolio management.” In investing, conventional wisdom of course preaches diversification, as well as owning the “best” companies with the largest moats (frequently, regardless of their valuations). As Asness and Brown write:

“A CIO who chooses an alternative investment that disappoints will face sharp criticism, even if the portfolio now has a better expected long-term ratio of risk to return (and succeeds unconventionally)...cheap stocks (using simple ratios like price-to-book or price-to-sales) tend to outperform expensive stocks. But they also tend to be “worse” companies – companies with less exciting prospects and more problems. Portfolio managers who own the expensive subset of stocks can be perceived as prudent while those who own the cheap ones seem rash. Nope, the data say otherwise.”

Call me rash, but I'm going to keep shooting my proverbial free throws underhanded – sticking with my unconventional, concentrated approach (which may deviate widely from the indices at times). I'll

⁴ Gladwell, Malcolm, “Revisionist History.” The Big Man Can't Shoot (July, 2017). [Podcast](#). [Transcript](#). The entire episode is very much worth a listen/read. I'm going to spare you a few “Ibids” - all Rick Barry information/quotes are from this source.

continue to willingly trade standing out from the safety of the crowd for the chance to put more (investment) points on the board over the long run.

Portfolio Update

At the end of the quarter, the partnership was 106% long by 13% short. Our top five positions were Clarus Corp (CLAR), Scheid Vineyards (SVIN), Turning Point Brands (TPB), IAC Interactive Corp (IAC), and Biglari Holdings (BH). Our top ten longs accounted for 84% of our long exposure.

Our top five positions are unchanged since year-end, with the exception of the addition of IAC Interactive Corp (IAC), which knocked Atento (ATTO) out of the top five. (Note, I have not reduced our ATTO position, and indeed have been adding to it as risk/reward in the company looks more attractive at recent levels.)

Clarus Corp (CLAR)

The underlying business performance at Clarus continues to exceed my expectations. Sales in the fourth quarter grew 11% y/y at Black Diamond Equipment (Clarus' core business), an acceleration from the high single digit growth rates of the prior two quarters. Momentum is strong entering 2018, driven by secular tailwinds in their core markets, new product innovation, and growing support for our products by key retail customers.

I performed additional due diligence on the company during the quarter, including meeting with a number of top executives at the Outdoor Retailer trade show. I continue to believe that the market has been slow to appreciate the positive change that the new president, John Walbrecht (now on the job for around 18 months), has driven. Eventually, investors should take notice.

Scheid Vineyards (SVIN)

Scheid Vineyards continues the process of coming out of "the dark" (as a reminder, publicly-listed companies that are not current filers of quarterly/annual financial reports are colloquially known as "dark" companies). In late March, Scheid made public their audited financials for the prior two fiscal years (ended February 28th 2016, and February 28th, 2017; the fiscal 2018 annual report should be released by the end of next month), as well as various additional disclosures. The company is now categorized as an OTC Pink Market *Current Filer*. The filings and disclosures can be seen [here](#) (scroll to the bottom).

In addition to the catalyst of increased disclosure and investor communication, tax reform should provide a tailwind for the company. Importantly, not only will the company benefit from the reduction in the corporate tax rate passed into law (Scheid is a full domestic corporate tax payer), but wine excise taxes were also reduced (for the first time in 80 years). Given Scheid's production capacity, they should qualify for the maximum excise tax credit, which is \$452k per year. These tax savings are meaningful in the context of the current earnings run-rate of the company.

While the discount has narrowed, Scheid still trades at roughly half of my conservative estimate of intrinsic value.

IAC Interactive Corp (IAC)

IAC is the long side of the arbitrage trade that I mentioned in last quarter's letter. We are long IAC and short their two core underlying publicly-traded holdings, Match.com (MTCH) and Angie's list (ANGI).

Every share of IAC, which trades for around \$162, owns roughly \$122/sh of MTCH and \$68/sh of ANGI, as well as net cash, real estate, a venture capital portfolio, an online publishing business, and an online video streaming business, which all together are worth perhaps an additional \$15-20+/sh (net of capitalized corporate overhead).

Again, the trade is not riskless, but we are "buying" \$15-20+ of net assets for *negative* \$28 per share. To put this into a slightly different context, if IAC were to spin out Match.com to IAC shareholders, IAC would be a ~\$40 stock which owned \$68 of ANGI per share, along with the net cash and additional assets of \$15-20 that I described above (\$85+ of value, for \$40/sh). IAC appears cheap on its own, but the ability to hedge out the risk of MTCH and ANGI makes it particularly attractive. While on a gross basis this is a moderately large position (large enough to break into our top five holdings), our net exposure to the position is fairly limited.

Atento (ATTO)

I discussed our position in Atento last quarter. At recent prices, the stock trades for 4x EBITDA and a double digit FCF yield. Importantly, before spending on growth, the FCF yield is over 20%. If the company decided to stop growing, and just spent what was required to maintain their current operations, it could buy back the entire market cap in under five years (and the current public float in under 18 months – recall, the company is two-thirds owned by Bain Capital).

Operations Update

Our operations continue to function smoothly. K-1s were sent to all limited partners in late March. The partnership's 2017 audit was completed by Spicer Jeffries, and copies of the audited financial statements were sent to limited partners in early April. I would like to thank our service provider partners who completed the tax and audit work in such a timely manner. They work hard behind the scenes, which allows me to spend the majority of my time focusing on investing matters.

Conclusion

Nassim Taleb's eagerly awaited (at least by me!) latest book was released in February, and it did not disappoint. As with all of Taleb's wide-ranging works, *Skin in the Game* does not lend itself to summary. But the core concept is easy to grasp: the architects, civil engineers, builders, fire code writers, inspectors, and the CEO of the company who will be well-compensated upon the completion of a building *on time and under budget*, should all live in the building.

Taleb writes, “the central attribute is symmetry: the balancing of incentives and disincentives, people should also be penalized if something for which they are responsible goes wrong and hurts others: he or she who wants a share of the benefits needs to also share some of the risks.”⁵

A financial planner who charges a fixed fee and recommends a high yield structured product (which happens to charge a large load up-front, and for which the financial planner receives a healthy kick-back – err – commission) that he or she would never invest in themselves, lacks ethics. There is a large, parasitic corner of the financial services industry that is solely dedicated to thinking up products that can be sold, but for which the creators of said products retain no risk, nor would ever invest in themselves (recall the mortgage originators discussed in the book and excellent movie adaptation, *The Big Short*).

I have worked hard to align interests across all facets of our partnership, from the fee structures to the planned assets under management (AUM) limit. But the crucial method of alignment is my large personal investment in the partnership – my *skin in the game*. If we get hurt, I feel it right along with you (with essentially all of my personal/family capital). This partnership is my sole business focus. I want to win (and importantly, I don’t want to lose). Not only do I have skin in the game, but soul in the game, too.

I’d like to welcome the new partners who joined our partnership in the first quarter. We continue to attract like-minded individuals – including fellow fund managers and entrepreneurs – and families who believe in our patient, value-driven, research-intensive approach. Our five year lock-up share class remains our most popular, and further, I think the majority of our partners join me in thinking about protecting and growing our capital together in terms of decades and even generations. I believe it is difficult to overstate the structural advantage that our stable capital base provides.

While I remain focused on the long term and don’t try to forecast short-term fluctuations in the market, I think that our current portfolio represents excellent value, with a number of upcoming catalysts. I feel good about our positioning. As always, please don’t hesitate to reach out with any questions or comments (or book recommendations – what books have you loved enough that you consider them worth re-reading?). Thank you for your continued trust.

Sincerely,



Dan Roller

⁵ [Link](#)

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