GREENHAVEN
ROAD CAPITAL

October 2024

Dear Fellow Investors,

The Fund[1] returned approximately +15% net during the third quarter, bringing year-to-date returns to approximately +12% net. Returns will vary by fund and investment class so please check your individual statements.

SELF-HELP

The last two letters have featured the Charlie Munger quote suggesting that "[t]he big money is not in the buying or selling, but in the waiting." There is a lot of wisdom in that short quote – compounding takes time, as does building an enduring business.

Collectively, as a partnership, we are outstanding at waiting. Unscientifically, I put us well into the top decile of "waiters" in this world. The ability to wait is a superpower. We can wait, we do wait, and we will wait, but even Munger would agree that waiting is not the only source of opportunity. Recently, we have been finding opportunities that I broadly place into a bucket I call "self-help." With so much of our portfolio requiring us to wait, self-help feels pretty good.

The first type of self-help opportunity is a business pursuing a transition that may yield a substantially better business. Sable Offshore, discussed in the appendix of this letter, is an example of a business helping itself. If they are successful, I believe the company can be worth multiples of today's share price. Sable's "self-help" process, if it happens, will occur over the course of months, not decades, and should be less correlated to the overall market as the catalysts are company specific.

The other type of self-help situation we have been looking at is balance-sheet-related. In smaller companies, there are times when the balance sheet is an issue; for example, too much debt and/or not enough growth capital. In these situations, our capital can help solve the problem, including by being a catalyst to help drive a "re-rating" of the shares. As a bonus, such purchases / infusions of capital often occur at a discount to the market share price.

For example, earlier this year, we invested additional capital into PAR as they raised money through a PIPE (Private Investment in Public Equity). The offering enabled PAR to fund their acquisition of restaurant technology provider TASK, which gave PAR an international product offering and both McDonald's and Starbucks as customers. The "catch," if there was one in the case of PAR, was that the shares we purchased in the PIPE had to be registered and thus could not be sold for approximately 90 days. Given our propensity for waiting, the illiquidity was acceptable. We helped a company that we firmly believe in significantly grow their addressable market AND got an 8% discount to the market price at the time. In part because of the acquisition we helped fund, PAR's share price has increased more than 30% since our investment and the discounted shares we bought in the PIPE (which are now tradeable) are up more than 40%.

[1] Greenhaven Road Capital Fund 1, LP, Greenhaven Road Capital Fund 1 Offshore, Ltd., and Greenhaven Road Capital Fund 2, LP are referred to herein as the "Fund" or the "Partnership."

GREENHAVEN ROAD CAPITAL

LIFECORE

After the third quarter ended, we participated in another PIPE of a company we already owned, LifeCore Biomedical, Inc. (LFCR). In this case, we invested not to help fund an acquisition but to instead strengthen the company's balance sheet. Our purchases were at a >10% discount to the market price, which I believe is temporarily depressed. The additional capital removes near-term liquidity issues which we believe should help the share price in the short term.

LifeCore is a contract development and manufacturing business (CDMO) that does the fill/finish for sterile injectables sold by drug companies. In layman's terms, when somebody injects themself with a single dose of Ozempic, that dose was formulated and packaged by a third-party CDMO using Novo Nordisk's recipe. This tends to be a good business as the fill/finish is a small portion of the overall costs and switching CDMOs requires FDA approvals, so churn tends to be low.

In addition to being "self-help," I believe that our LifeCore investment has been timely. The LifeCore CDMO business had been buried inside of an packaged goods conglomerate that sold salsa, packaged salad, made guacamole, and imported olive oil, in addition to manufacturing drugs. There was no industrial logic to the combination, the CDMO was not better off because of the lettuce. In the past year, LifeCore finished its divestitures of its other holdings and is finally a "pure-play" CDMO business.

The divestiture of the agriculture business led to re-statements of audited financials. The restatements, in my opinion, were not material to the company's financial condition (six figures in magnitude), but had the impact of the company being "dark" and not reporting current financials or hosting earnings calls. After more than a year, that "dark" chapter ended this summer, making the company analyzable using reliable financial statements (low bar I realize).

LifeCore has a new CEO, who has turned around three previous CDMOs, as well as a new CFO who was the CFO for another CDMO that was acquired. This is to say that they have relevant industry experience and relationships. Following the recent capital injection, I believe the biggest risks to the business are execution risks. From here, the marching orders are clear – sell new business and improve margins.

LifeCore just went live with significant new manufacturing capacity, an undertaking that took almost four years to get online. With now almost doubled capacity, LifeCore now operates at less than 35% utilization, meaning that it can almost triple revenue with virtually no additional capital required.

LifeCore hit an "air pocket" this year as their largest customer, Alcon, is "de-stocking"/lowering inventory levels, which impedes growth for 2024; however, there are several years left on their contract, which has required minimums that increase over time. Rising contractual minimums and investments in sales and marketing provide ingredients for the company's sustained double-digit revenue growth. Management's medium-term growth guidance is "at least 12%," which should not be a heavy lift as this CMDO business historically has grown organically at 12% per year, and the broader sterile injectable market is similarly projected to grow at 12% per year.

While LifeCore does not currently manufacture Ozempic, Wegovy, or any of the GLP-1 drugs – important drivers of the industry's growth – they are equipped to do so. Management has hinted at GLP-1 conversations, which if came to fruition could take most, if not all, of the existing spare capacity. Given that Eli Lilly and Novo Nordisk are severely capacity-constrained on volumes, which are expected to continue exploding, industry capacity should continue to be absorbed by GLP-1s benefiting LifeCore even if they do not sigh directly. In a recent interview (link) the Eli Lily CEO indicated that there are 41 countries where their GLP drugs are approved but have not launched because of manufacturing capacity constraints. They cannot make GLP-1s fast enough.

While helpful, we don't need a GLP-1 contract for this investment to work. LifeCore is selling capacity into an industry that is constrained. Their new CEO ran business development when he was at Mylan (market cap $9.5B before merger) and LifeCore historically grew at >10% with effectively no sales force. Contractual minimums alone will increase revenues even with zero new customers. A future world where LifeCore is growing is eminently plausible.

More important to the investment thesis than the expected revenue growth is the potential to improve margins. LifeCore's EBITDA margins are currently 15%, while several industry peers are 30%. Margins should improve as volumes increase/capacity is utilized, but, even without growth, there is opportunity on the cost side.

Since becoming CEO, Paul Josephs has overseen a round of layoffs and targeted cost savings, in addition to some non-recurring expenses rolling off, all of which will improve margins going forward. Management has stated that they believe such basic blocking and tackling efforts can get margins to at least 25% over the medium term. If management is successful in this 66% margin growth (15% to 25%) while growing revenues at 12%+ per year, simply holding multiples steady would see us more than double our money over that timeframe. If we see margins reach the industry average of 30% with the same 12% growth, you have line of sight to a triple.

The potential third engine to drive returns is multiple expansion. The shares we purchased were trading at <15X what I think is an already depressed EV/EBITDA, while two recent acquisitions in the space have been made at >25X (Catalent at 31X and Biovectra at 27X). We don't need multiple expansion for the investment to work, but it is plausible and could get us into 5-bagger territory. LifeCore will hold its first investor day on November 21st and will begin to actively "get the story out" from there, which, along with growth, will be key to any multiple expansion.

While our recently purchased LifeCore shares have had a +25% "pop" with the balance sheet concerns reduced, this "self-help" investment will still require waiting. The CDMO business is attractive, in part because of very low customer churn. Unfortunately one of the primary reasons that churn is low, is that it takes two years to onboard new business because of regulatory requirements and approvals. In the very near term, growth will be flat to down. With previous signings and Alcon returning to their contractual minimums, growth should return, but today's investments in sales and marketing will take two-plus years to show up. Margin improvement can happen more quickly and, if there is line of sight to revenue growth, multiple expansion can happen as well, but I think Munger will be right yet again in that the big money (if it comes) will be in the waiting with LifeCore.

TOP 5 HOLDINGS

Greenhaven Road's current top five investments are all companies that I have written about extensively in previous letters. I will review them in the context of what has been accomplished in the time that we have owned them, while we "waited."

PAR Technology (PAR) – We have owned restaurant technology provider PAR for approximately five years and began buying when the share price was in the $20s. Major accomplishments over the past five years include:

1) Improving the POS (point-of-sale) code base to improve stability, which laid the foundation for growth.
2) Executing five acquisitions that expanded the addressable market, product lines, and provided scale.

3) Winning Burger King and Wendy's as customers. These Tier 1 wins have led to the biggest RFP pipeline in the company's history.
4) Divestiture of government business to become more of a "pure play" enterprise software company.
5) Growing the ARR/Share from $1.04 to $5.30 (as of June 30, 2024) with line of sight to >$8.
6) Inflecting to profitability (while not yet reported, I think it happened in Q3 of this year).

This is a vertical market software company with accelerating growth and inflecting to profitability. The markets are bigger, the products are better, the customers are larger, and team is deeper. The future is far brighter than when we invested 5 years ago.

KKR (KKR) – We have also owned asset manager KKR for approximately five years. Over the last five years, KKR has grown AUM from $206B to $601B and perpetual capital from $19B to $250B while also expanding its focus on products for insurance companies with the acquisition of Global Atlantic. Over the past few years, KKR's investment in distribution to high-net-worth individuals has dramatically grown their investor base. Given the progress, it is not surprising that shares are up 5X over the last five years. At their most recent investor day, KKR management laid out a path (for those who wait) to quadrupling earnings over the next ten years.

Cellebrite (CLBT) – We have owned Cellebrite for approximately three years. The company remains the go-to software solution for law enforcement to access and analyze cell phone data for criminal cases. Product enhancements have improved and broadened the value proposition, and the company has raised prices and sold more "seats" as they have delivered more value to their customers. We began buying shares in October 2021 and averaged down from there. In the period we have owned the shares, ARR (annual recurring revenue) has grown from $187M to $345M while remaining profitable. The company took out the SPAC warrants.

I do think it is worth articulating a medium-term possibility for Cellebrite. The company's products are used to extract evidence from digital devices, analyze the data, and ensure that search warrants are complied with. The demand for Cellebrite's tools to analyze encrypted data from advanced cell phones and other devices is likely to persist at high levels for a long time. Can you really imagine an investigation where the subjects cell phone is not looked at for geolocation data, calls, emails, texts, photos, or web browsing history?

If you believe, as I do, that distribution will be critical for vertically focused AI products, Cellebrite is perfectly positioned. The company has products and relationships in just about every major law enforcement agency. AI is the buzzword of buzzwords, but Cellebrite customers have extensive case backlogs and human capital shortages that are ripe for additional tools. Cellebrite is already touching the data and has required guard rails in place to ensure legal compliance with constraints like search warrants. If you have played with the recent AI tools like Perplexity Pro or NotebookLM, which can parse enormous amounts of data, it is not hard to envision use cases for law enforcement struggling with exploding amounts of data. Cellebrite has a large opportunity in front of them to sell increasingly more powerful tools into law enforcement. If their products can solve more cases and provide labor efficiencies, customers will pay. Cellebrite is well positioned to develop and sell the next generation of AI analytics tools. If well-built the productivity gains will allow them to raise prices, raise prices again, and then raise them again while still delivering great value to their customers.

Burford (BUR) – We have owned litigation financer Burford for less than two years, but the progress was not long in waiting. Substantial developments in their legal case against Argentina have occurred, with the potential proceeds being multiples of BUR's current share price. The Argentina case is far from their only valuable asset and Burford also holds another $5B of cases in their portfolio that could be worth substantially more.

Hagerty (HGTY) – We have owned classic/collector car insurance company Hagerty for approximately three years. During that time, revenues have roughly doubled and profitability has flipped from a negative to a positive, all without substantial contribution from their strategic partnership with State Farm. Over that same period, the company launched an online marketplace and in-person auction business for classic/collector cars, both of which are likely in the top 5 for the industry. Combined with a recent acquisition that greatly expands the post-1980s car insurance opportunity, Hagerty is well-positioned for higher growth over the next five years.

SHORT SIDE

We remain short the flying taxi company that has the trifecta of regulatory risk, technology risk, and business model risk – and you could arguably throw in a healthy dose of execution risk but still has a market cap of more than $4.5 billion. We are also short two companies facing significant litigation with the potential for treble damages (i.e., 3x the actual amount) for their actions and potential liabilities far in excess of their market capitalizations. We are also short two major indices.

OUTLOOK

Our Partnership is well set-up for self-help investments. Through our Partners Fund[2], we have extensive relationships with other managers and are the beneficiary of a lot of "looks" at opportunities. With an investment committee of one, we can act quickly. We are big enough to make a difference to smaller companies and small enough that our investments can make a difference in our returns.

With a concentrated portfolio of idiosyncratic companies, our returns have and will continue to come in chunks. As we "wait," progress is being made. I think we hold multiple multi-baggers and believe that the table is set for another "chunk" of returns.

Sincerely,

Scott

[2] Greenhaven Road Capital Partners Fund LP, a boutique fund of funds

NEW POSITION APPENDIX – SABLE OFFSHORE CORPORATION (SOC)

There are certain attributes of a business that I find attractive. Among the very top are recurring revenue, operating leverage, high insider ownership, and a high free cash flow yield. If we are lucky, we typically get three out of the four attributes, but rarely all four.

In the decade-plus existence of Greenhaven Road, we have made exactly zero investments in oil and gas companies, in part because I struggle with having a strong view on the underlying commodity. There is an argument that oil is a finite resource and a critical input for transportation, and thus there are industrial economies supporting a higher-for-longer price. We always seem to be one geopolitical event away from a spike in oil prices. However, there is also an argument that technologies such as fracking have unleashed a wave of supply that will overwhelm the demand that is already declining due to electric cars and improved technologies, a result that does not support the sustained higher prices for oil thesis.

I see merits in both arguments and, therefore, don't have a strong view on the price of oil. That said, I do have a loosely held belief that consumption will increase as incomes rise for billions of people across the developing world. I have a vivid memory of traveling in India and seeing a family of five riding a moped. I regularly saw three or even four people on a single vehicle, but this was a record. Many of those families would likely have preferred to be in a car, on two mopeds, or, even better, in two cars. Every combination implies greater oil consumption in the medium term as incomes rise.

Adding to my overall skepticism is the fact that every oil and gas company I have ever looked at always claims to be "advantaged" in some way, with very colorful maps to prove with certainty how much oil is in their acreage and why they have some cost advantage. As a generalist, those maps make my "somebody is trying to screw us" antennae go on high alert.

My father had a varied business career. He worked in advertising during the Mad Men era, ran the U.S. operations of a high-end dinnerware business, and eventually bought and ran a shoe polish company that put my sister and me through college. Most of his business conversations were about shoe polish and were mundane, but I do remember one conversation about an oil well in Texas that his friend was raising capital for. I could only hear one side of the conversation, but even as an eight-year-old, I understood that the geology looked VERY promising.

My father invested in the well. It was exciting! If they did strike oil, we were going to be rich and, if I had any say in how we spent the proceeds, we would get a swimming pool. As you may have guessed, despite my father investing in not one but two promising wells, no oil was found. The closest I got to having a swimming pool was my pool cleaning career – three summers of pool vacuuming and scrubbing liners. If only there had been oil….

This past quarter, we invested in an oil and gas company, Sable Offshore Corporation (SOC), that came public via a SPAC. Indeed, given the industry and the fact that it was a SPAC, your "somebody is trying to screw us" antennae should be up, as mine was and still is. This investment is sized small. Like my father's ill-fated oil well, this has "multi-bagger" potential, and I estimate the risk of a total loss of capital is very low, but there is that possibility.

Like my father's oil investment, our oil investment is not currently producing any oil or gas. However, unlike my father's investment, Sable Offshore's oil field has a history of being very productive.

In the 1980s and 1990s, Exxon operated three oil platforms off the coast of Santa Barbara. The underlying Santa Ynez field was one of Exxon's most productive. When the field was operating, Exxon was the largest taxpayer in Santa Barbara County and produced approximately 15% of the oil in the state of California.

Unfortunately, in 2015, production came to a screeching halt when there was a leak in the pipeline that takes the oil from onshore holding tanks to gathering facilities in Bakersfield, California. It is estimated that approximately 4,000 barrels of oil leaked from the onshore pipeline, some of which ran down the hillside into the ocean. As oil leaks go, 4,000 barrels is quite small (the Exxon Valdez spill was 11 million barrels), but production was appropriately shut down because the pipeline was compromised.

The oil platforms, holding tanks, and pipelines have been idle since then, with Exxon paying roughly $70M a year to maintain the platforms, waiting for the day when production could re-start. Unsurprisingly, nearby oil platforms are not popular with Santa Barbara voters. While the platforms are technically in federal waters and outside of the regulatory reach of the State of California and the County of Santa Barbara, the pipeline and holding tanks are in Santa Barbara itself, and local players have taken the opportunity to try and make a re-start as difficult as possible.

From 2015 to 2023, Exxon waged a legal battle with the county of Santa Barbara in an attempt to re-start operations. Very little progress was made towards opening the site and, during this period of legal acrimony, California became an increasingly unattractive location for multinational oil companies like Exxon to operate. California's onerous regulatory approach imposed standards for operations, such as rapid response levels, to the entirety of a company's operations, even those outside of California.

The net result of the aggressive approach was that many multinational oil companies decided to leave California. Occidental Petroleum spun off its California assets into a separate company and Chevron announced its departure from the state.

By 2023, Exxon's only California operation was a closed Santa Barbara oil field that was costing $70M+ a year to maintain with no end to the expenses in sight. Enter Jim Flores, an oil and gas entrepreneur who had built and run an oil and gas company called Plains Exploration and Production, which was ultimately acquired by Freeport McMoRan. Plains Exploration had a successful track record of operating offshore platforms. Jim then raised a SPAC to invest in an oil and gas asset and made an interesting offer to Exxon Mobil to take the Santa Barbara problem off their hands. He got Exxon to contribute the Santa Barbara operations to his SPAC to form Sable Offshore Corporation, which would have two years to get the operation up and running. If it failed, Exxon would get its property back. If Sable succeeded, Exxon would get $720M plus some interest. Either way, Sable would be responsible for the legal expenses and re-opening costs. For Exxon, it was a path out of California. For Jim Flores, if successful, it was a large oil and gas operation acquired for pennies on the dollar. Jim and his family invested $33M out of pocket into the deal.

On paper, Jim negotiated a pretty good deal… IF he could get the approvals to operate. There are a few ways to triangulate the value captured if he could produce

- Exxon took a $2.5B write-off, so they were carrying the assets on their books for substantially more than Sable Offshore was paying them.
- The stated value of the oil in the ground (PV-10) was (is) approximately $10B. This ignores the onshore real estate (1,400 acres in Santa Barbara) and the pipelines.

- At the time the field was shuttered, it was producing 12 million barrels of oil per year. Sable projects that, at a run rate of 10 million barrels per year, the company would generate $374M per year in cash.

The Exxon/Sable Offshore deal closed in February. The challenges in front of Jim and his team were substantial and the clock was ticking. When the SPAC first closed, an investment in Sable Offshore was much more about the likelihood of overcoming regulatory challenges in the prescribed time period than about the underlying assets. Betting on a speedy outcome from a contentious environmental issue is not a very interesting risk/reward in my opinion.

While the company is quick to point out that the oil wells are in federal waters and thus governed by the federal government, getting the oil to the storage tanks and through the pipelines requires approvals from the State of California and the County of Santa Barbara where “drill baby drill” is not the predisposition of most residents or politicians.

To compound the regulatory challenges facing the company, the property owners of the land through which the pipeline ran were arguing that the pipeline’s easements had expired and that Exxon/Sable had no right to access the pipeline to repair it.

In my opinion, the risk profile of Sable Offshore changed in September. Santa Barbara was facing a $10B lawsuit from Exxon/Sable, and the county effectively settled the case by agreeing not to further delay the beginning of operations and to approve Sable’s pipeline repair plans. Between the settlement in September and a consent decree from 2020, the following entities have effectively blessed the restart: U.S. Department of Justice (DOJ), U.S. Department of Transportation: Pipeline and Hazardous Materials Safety Administration (PHMSA), U.S. Environmental Protection Agency (EPA), California Department of Fish & Wildlife: Office of Spill Prevention and Response, California Department of Parks and Recreation, California State Lands Commission, and the California Department of Forestry and Fire Protection (Office of the State Fire Marshal).

Concurrently, the company also reached a settlement with the property owners to resolve the easement disputes. For a brief period, it appeared as though all regulatory issues were resolved and that it was just a matter of finishing the pipeline repairs that Sable Offshore had agreed to with all of the previously listed parties. Earlier this month (October), the California Coastal Commission inserted itself into the process. Still, while the regulatory issues are therefore not 100% in the rear-view mirror, there is line of sight to that reality and the remaining issues are far smaller in scale and scope. Given the settlements already achieved and the $250M+ cash legal war chest the company has (PIPE+Warrant conversion proceeds), an analysis of the underlying assets has become far more germane.

Scenarios outlining “what could go wrong” are pretty easy to map out. In fact, there are two short reports on Sable Offshore and, as previously stipulated, there are paths to losing our capital if the company cannot navigate the legal/regulatory challenges.

It is also worth asking the question, “what could go right?” Given that the field has been closed for almost a decade, there are not relevant historical financials; however, the company gave projections as part of the SPAC closure process. In most cases, SPAC projections should be heavily discounted, but given that Sable was about to embark on negotiations with property owners and regulators when they shared these projections with investors, there may have been incentives to be more conservative in generating those projections than the typical SPAC would be.

These potentially conservative projections called for 10 million barrels of oil production per year at $70/barrel to generate $374M per year in cash flow. At $100/barrel, cash flow increases to $634M. There is clearly operating leverage in these scenarios, with the 43% price difference per barrel ($70 to $100) driving a 70% increase in projected cash generations. The cash generation potential of Sable Offshore is driven primarily by the price of oil (as shown above) and volumes.

In the past, this field produced substantially more than 10 million barrels per year. It produced 12 million in its last year of production and had years where it produced more than 20 million. There are close to 100 well heads in the oil field and only 3 of them were using Electronic Submersible Pumps (ESP), a technology that can substantially increase production with low capital intensity. In the "what can go right" scenario, there are credible paths to 15 or 20+ million barrels per year for decades.

There are pricing and volume scenarios where the field could generate in excess of a billion dollars of cash per year. It would take a few hundred million dollars of capex, but against a sub-$2 billion market capitalization and sub-$2.5B enterprise value – IF Sable can begin production – there is a path to a free cash flow yield in excess of 50%. IF oil prices are higher AND production volumes are robust, the share price should increase substantially.

The Santa Ynez oil field has three attributes that are attractive to investors:

- **Slow Decline:** the company is estimating 8% YoY 5-Year Annual Average Resource Decline. This is substantially better than shale and reduces the re-investment rate required to maintain projected production.
- **Low Cost:** it is estimated that it will cost below $16 per barrel to extract the oil, which is substantially below shale.
- **Large Field:** there are decades of drillable oil in this field.

We can disagree about what the right multiple is for a single oil asset in California is but, IF they can restart production, I believe there are several paths to the share price rising 3X+. There are also opportunities for carbon sequestration, as well as monetizing the gas produced from the field, which actually has value in California due to it being an "energy island." Right now, Sable Offshore is a SPAC trying to restart oil production in the very green state of California. IF we get to the point that they are actually producing, I think a new wave of investors will emerge and it will be valued like any other oil and gas asset.

As previously discussed, the CEO and his family invested $33M of cash into the company in exchange for shares at $10. They subsequently sold their plane to the company for shares at $24 and, through the magic of SPAC economics, were granted shares for their sponsorship and involvement. The net result is that Jim Flores and his family own approximately 11.2 million shares and have warrants for an additional 6.5 million shares. On a fully diluted basis, they own approximately 20% of the company. The Flores family is well incented to navigate the approval process and to improve the productivity of the oil field.

Returning to the criteria I laid out at the beginning for investments, IF Sable can begin production, I think it should have all four. There is high insider ownership (20%), operating leverage, recurring revenue, and a high free cash flow yield. In that scenario, the right price is not $20.

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