August 2024

Dear Partners and Friends,

In the second quarter, the partnership returned +4.4% net of all fees and expenses,[1] which brings the year-to-date return to +7.9%, net. Over the past five years, the partnership compounded at a rate of greater than 13% annually, net, more than doubling the gross return of the Russell 2000. Annualized alpha since inception vs. the Russell 2000 has been 8%.

As usual, I caution you not to place much emphasis on our short-term results. Our fund looks different from the market because we are seeking results that are different—i.e., better—than the market over the long term. We are concentrated in a handful of positions that I believe I have researched thoroughly and have asymmetric return profiles with a number of ways to "win." This approach means that our short-term results may deviate widely from various stock market indices. Many of our positions are small caps and some are quite illiquid, which can exacerbate volatility. I remain focused on process and what is in my control. Our structure, underpinned by you—our fantastic partners with patient, aligned capital—allows me to attempt to take advantage of market volatility, rather than be whipsawed by it.

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Horizon Kinetics Holding Corporation (formerly known as Scott's Liquid Gold-Inc.; SLGDD/HKHC[2])

We held the proverbial presses on this letter so that I could share the fantastic news that Scott's Liquid Gold's ("Scott's") merger with Horizon Kinetics ("Horizon") has closed. Horizon is an asset management firm run by a renowned team led by contrarian value investor Murray Stahl. He is joined by his partners Steven Bregman and Peter Doyle and a capable operating and investment team in managing Horizon's nearly $8 billion of assets under management (AUM) and the $250 of million Net Tangible Assets on its balance sheet.[3] Horizon's public market debut coincides with the 30th anniversary of its founding in 1994 and the fifth anniversary of Maran Capital's involvement in Scott's.

Maran first invested in Scott's in the fall of 2019 (though we strategically and opportunistically added to our position over time). I joined the board of Scott's in January 2021 and became its chairman in April 2021. Over the subsequent few years, we cut costs, sold eight brands in five separate transactions, and repaid all debt, taking the company to a net cash balance sheet. It was from this position of strength that Scott's negotiated and entered into, in December 2023, the merger agreement with Horizon.[4]

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[1] Net returns based on the fund's highest fee share class. 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 7 for important disclaimers, and our investor presentation for complete monthly results since inception.
[2] The Company's common stock is expected to trade under temporary ticker symbol "SLGDD" for approximately 20 trading days starting August 5, 2024 before trading under its permanent symbol "HKHC."
[3] AUM ($7.9 billion) and Net Tangible Assets ($250 million) as calculated for the close of the transaction as defined in the merger agreement.
[4] This paragraph alone could be expanded into the contents of an entire essay or business school case study. While this letter is already delayed and must be sent out, I hope to share more on the key takeaways and learnings from this experience in the future.

I would like to thank Murray Stahl and the entire Horizon team for their partnership and collaboration as we executed this transaction. I would also like to thank Tisha Pedrazzini (board member, President), David Arndt (CFO, President), and John McAnnar (board member) for their tireless efforts in transforming Scott's and assisting in the execution of the transaction with Horizon.

I would especially like to thank Rimmy Malhotra, whose title of board member of Scott's doesn't begin to do justice to the role he played in this successful outcome for Scott's shareholders. He was a true partner in this endeavor and his strategic advice and skill at execution were instrumental in the outcome. Thanks again, Rimmy.

The press release announcing the close of the transaction can be read here:

Horizon Kinetics Holding Corporation Announces
Closing of Merger with Scott's Liquid Gold-Inc.

Horizon remains a core position in our fund, and I intend to continue to serve on its board of directors. As such, the information and analysis that I share in these letters regarding this position may continue to be limited. I am excited about the future of the company and look forward to sharing more as appropriate.

Returning to Turning Point Brands (TPB)

In my first quarter 2024 letter, I indicated that we had purchased shares of a company, making it our sixth largest position. This company is now firmly in our top five. It will be familiar to long-time partners and readers of these letters: Turning Point Brands ("TPB").

Turning Point Brands is comprised of Zig Zag rolling papers and a portfolio of non-combustible nicotine products, including Stoker's (oral tobacco) and—spoiler alert—a non-tobacco nicotine pouch product called FRE. Zig Zag benefits from the tailwind of cannabis legalization currently underway in the U.S., and Stokers continues to take share and benefit from an industry pricing umbrella.

There are times when stocks get ahead of themselves; when a thesis breaks; when fundamentals weaken; or management makes mistakes. We must always attempt to be rational in the face of change, and when faced with certain situations, to sell and move on. Just as importantly, when we know a name well, it makes sense to continue to track it as the set-up may improve and create opportunities down the line. I have followed TPB since its IPO in 2016. We owned it as a core position from the first quarter of 2017 through the third quarter of 2018, and then again from the second quarter of 2020 (following its merger with its parent holding company, Standard Diversified) through the third quarter of 2021.

Despite its solid core in Zig Zag and Stoker's, Turning Point had a tumultuous 2022 and 2023 as investments it made in vaping faltered, among other challenges. I continued to monitor the company during this period, though, doing checks on the brands, business, and team.

While investors fled the stock, the company was making numerous beneficial changes: it transitioned its senior management team (new CEO, CFO, and Chief Revenue Officer), de-emphasized the vaping segment, optimized inventory, generated cash (as always), paid down debt (including buying some of its converts at a discount), and incubated FRE. As a result, I think the TPB story is as exciting as ever, but it is only just starting to get back on investor radars.

TPB has a ~$650 million market cap and $225 million of net debt, bringing its enterprise value to approximately $875 million. It should generate approximately $100 million of EBITDA and $50-$60 million of free cash flow this year.

TPB is trading at a high single-digit free cash flow yield (low teens on our cost basis). Its core brands (Zig Zag and Stokers) should drive mid-single-digit growth in EBITDA. If the stock re-rates from just over 10 times free cash flow to the mid-teens over the next three years, that would add over 10 percentage points per year to the expected return. These components (high single-digit starting yield, mid-single-digit growth, 10%+ from multiple expansion) should therefore drive an expected mid-20% return profile (the "three-year double" for which I like to underwrite).

If this were the whole thesis, it would be sufficient. But there is an additional source of meaningful upside that I believe the market does not yet appreciate. This is the company's nicotine pouch product called FRE.

Nicotine pouches deliver nicotine without tobacco. ZYN, owned by Philip Morris International (PM), is the market leader in this category, and will almost certainly remain in that position. That said, Turning Point has an excellent playbook for capturing market share and growing brands under the umbrella of larger competitors. It has grown Stokers to a high single-digit market share against entrenched competitors, for example.

Nicotine pouches are riding a huge wave of global growth—one which could continue to build for decades. The U.S. nicotine pouch market is $2.5-$3 billion and will likely double in the next few years. To give a sense of the growth rates, PM's ZYN has grown from 13 million cans sold in the U.S. in 2018 to 174 million in 2021 to 385 million in 2023. It will likely top 550 million cans this year if production can keep up (there have been numerous recent reports of ZYN out-of-stock issues).

Despite FRE's small market share, it has a number of competitive advantages and moats. First of all, it has PMTAs (premarket tobacco product applications) for each of 3, 6, 9, 12, and 15mg pouches, and is already in market with the latter four dosages. Most of its competitors are only in market with 3mg and 6mg versions, and don't even have PMTAs for higher dosages (which means it could take them several years to launch them, if they chose to try).

While FRE capacity is a fraction of ZYN's, FRE has established a robust supply chain. It has expanded capacity and is positioned to continue to do so. This should drive trials and conversion while ZYN faces capacity limitations.

FRE has been a fun one to research. I still think it is very early days and that not many investors are paying attention to it. The company has kept disclosure regarding FRE close to the vest, so independent research has been rewarding.

Based on both top-down and bottom-up assumptions, I believe FRE has a chance of growing to a $100 million revenue brand in the next few years. If things go very well, it could even take 5% share of a $5 billion (and still growing) market over time (i.e., $250+ million of revenue).

What is a high-growth, high-margin consumer brand in an emerging category worth? PM paid over seven times revenue for Swedish Match (the prior owner of ZYN). Even four times revenue (which implies a low double-digit multiple of EBITDA) would mean that FRE could attain a value of $400+ million in the next few years (and the blue-sky scenario is that FRE could eventually be worth $1 billion or more). These are very meaningful numbers relative to TPB's current market cap of ~$650 million.

In my interactions with the TPB board and management team, there seems to be a renewed energy and determination, kindled in part by FRE. They appreciate the magnitude of the current opportunity and want to take advantage of it. These insiders are putting their money where their mouths are. Several executives, including the Chief Revenue Officer and Chief Strategy Officer, have recently purchased TPB shares in the open market. Additionally, TPB's newest board member purchased over 2% of the company, a position worth over $15 million.

Capital allocation remains a further lever for value creation. After paying off its convert with cash on hand this summer, TPB restarted its buyback. TPB could comfortably repurchase up to one million shares per year (on a base of 17.6 million), even while continuing to invest in FRE. Compared to legacy tobacco companies, which generally have no—or negative—growth and pay high dividends, TPB is unique: a growth nicotine and cannabis-adjacent company that can be a share buyback machine. We already own the "NVR of the U.K." in Vistry; I'm hoping TPB, this time around, can become the "Autozone of nicotine and rolling papers."

TPB should generate $3.50-4.00 of normalized free cash flow per share next year, and over $5.00 by 2027. If it trades at a 15-18x multiple, that would put its value at $75-90 per share in a few years, and there is no reason to think that TPB can't continue to compound from there (that is, if it isn't bought out by one of the tobacco majors first). It just needs to avoid distracting M&A, execute on the brands it owns, and shrink the share count while maintaining appropriate leverage—and I believe, under the current management team, that it will.

The profile of our investment in TPB is similar to many of my prior favorites. I believe that we have limited risk of permanent capital loss; a core business that can drive excellent performance on its own; and an additional asymmetric source of potentially meaningful upside. If FRE disappoints, our investment in TPB should still be solid. If FRE is a real winner, though, then watch out.

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Portfolio Update

Our top five positions as of mid-year were Clarus Corp (CLAR), Correios de Portugal (Euronext Lisbon: CTT), Horizon Kinetics Holding Corporation (formerly known as Scott's Liquid Gold), Turning Point Brands (TPB), and Vistry Group (LSE: VTY).[5]

Clarus Corp (CLAR)

I have discussed Clarus at length in recent letters. While the consumer remains weak, Clarus is working to strengthen its brands with new hires, reduced SKUs, and improved structural margins. Some of these things will take time to show up in the numbers.

[5] Listed alphabetically.

The stock remains cheap relative to the private market value of its brands. Given its net cash balance sheet ($1.50+ per share by year-end on a $5 stock) and healthy free cash flow generation (it should generate cash this year despite the challenging industry backdrop), I think the stock is asymmetric and our risk of permanent capital loss is limited. Looking out three years, I think there is less than $1 per share of downside and plus or minus $10 per share of upside.

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

After finishing its prior authorization in May (which was for €20 million), CTT recently announced a new share buyback in the amount of €25 million. CTT has reduced its share count from 150 million shares to 138 million shares since 2022, and at recent prices, it can repurchase another six million shares under this new authorization. It started its buyback aggressively, repurchasing over 250 thousand shares in the first week. The CEO and Chairman each also purchased shares in the open market.

Horizon Kinetics Holding Corporation (SLGDD/HKHC)

Discussed above.

Turning Point Brands (TPB)

Discussed above.

Vistry Group PLC (LSE: VTY)

Vistry's first-half results were solid; the "NVR of the U.K." thesis is playing out. Completions, revenues, and profits are growing, and Vistry's share count keeps shrinking (recent pace of buyback: £250 million annually). Vistry is well-positioned to support the U.K. government's housing policies.

This remains a top idea and I expect this to be a company that we can own for many years.

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Beyond the Top Five | Special Situations

We established a position in a company that I expect to sell itself in pieces over the next 18 months; processes to sell the majority of assets by value are underway. I think this could generate a 60% - 100% return in six to eight quarters while asset value helps protect against downside.

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Conclusion—The Nassim Taleb Wall of Shame

Volatility has increased in the market, and it seems to be catching some people off guard. This is not to say that I predicted this bout of volatility, but just that I always attempt to be both positioned and mentally prepared for periods of increased volatility—they are inherent to the nature of markets. Commentators have been quick to highlight how "surprising" the volatility has been:

"Nearly 4-sigma volatility in [ ] this month."

"…[ ] volatility was a 1 in 4 million event."

"Small caps outperformed large caps by [ ]% today, a 6 standard deviation event."

But is it really that rare? Assuming a normal distribution, a four-sigma event should happen once in several decades. Five-sigma: Once in thousands of years. And six-sigma: Once in millions of years. In the world of listed securities, these types of events—in some asset class or other—seem to happen all the time, though. What's going on?

The obvious answer is not that exceptionally rare or unexpected events keep occurring, but that the statistics are wrong (or rather, people are using the wrong statistics). Simply put, markets do not exist in the Gaussian world of normal distributions. They live in what Nassim Taleb calls "extremistan," the world of fat tails. And the "sigmas" and "standard deviations" referenced above are based on normal distributions. In other words, you won't have to wait around thousands of years for what is proclaimed as the next "five sigma" event in the stock market, I promise.

Whenever I see headlines proclaiming N-standard deviation events, or N-sigma moves, I think that they belong on what I call the *Nassim Taleb Wall of Shame*. Taleb, author of *The Black Swan* and proponent of clear thinking about risk and uncertainty, would not be proud of those writing or uttering these lines. And we have seen more than a few such examples in the last few weeks. Volatility may continue to be high for a while, or markets may settle. Perhaps the tides are starting to turn on a longer-term basis with respect to the large-cap technology leadership of the market, or perhaps not.

Regardless, we should never be surprised by bubbles forming and bubbles popping; by momentum going farther than we expect; by the cheap getting cheaper (or eventually bouncing back); or by or volatility picking up "out of nowhere." It is wise to maintain a certain level of equanimity when it comes to short-term movements in stock prices.

As usual, I remain focused on the long-term.

And with that perspective, I am excited about our portfolio and believe we are well-positioned. I continue to remain aligned with you via my meaningful *skin in the game* in our partnership.

Thank you for your continued trust.

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.

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 2024, the return of the S&P 500 was +4.3%, and the return of the Russell 2000 was -3.3%. 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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