January 2024

Dear Partners,

For the fourth quarter, 1 Main Capital Partners, L.P. (the "Fund") returned 23.8% net, bringing its year-to-date return to 48.9%[1]. This compares to full year returns of 26.3% and 16.9% for the S&P 500 (SPX) and Russell 2000 (RTY), respectively.

Since its inception nearly six years ago, the Fund has delivered an annualized net return of 23.2%, compared to 11.2% and 5.7% for the SPX and RTY, respectively. Accordingly, a $1 million investment at inception would be worth $3.4 million today, after all fees and expenses. The same amount invested in the SPX or RTY (with dividends reinvested) would be worth $1.9 million and $1.4 million, respectively.

The Fund's returns have been generated primarily by owning a collection of high-quality, well-managed, and well-capitalized businesses that were positioned to grow earnings per share at attractive rates. Importantly, the multiples at which we initiated many of our positions have tended to represent a source of upside—rather than downside—to the value of our investment. Accordingly, some of our biggest winners over the years benefited from both substantial earnings growth and multiple expansion.

As an investor, I'm proud of these results but also try to take on the mindset of a professional athlete: celebrate the victories, analyze the good and bad plays to improve, and look forward to the next opponent. My goal is the same today as it was on day one—to continue compounding the Fund's capital at attractive levels for the decades to come without going far out on the risk curve.

In that regard, several of you have asked me whether now is a good time to add to your investments in the Fund. My response is that, while I believe it is nearly impossible to time markets, I continue to have strong conviction that our top holdings remain significantly undervalued and have attractive growth prospects. Moreover, while I do not ordinarily comment on intra-period performance, it is worth pointing out that the Fund has declined by high-single digits in the first three weeks of 2024. I would very much welcome the opportunity to buy this dip and own more of my highest-conviction investments at current prices.

As always, while I am thinking in years rather than quarters, I am optimistic about the prospects for the Fund's portfolio and look forward to seeing what the future has in store.

Keeping an open mind

In investing, having an open mind is essential for loss avoidance and profit maximization. Still, maintaining flexibility is one of the many challenges portfolio managers face in evaluating new and existing positions.

Open mind, new ideas: When looking at new ideas, PMs are fighting a constant battle between (i) giving them a fair chance before ruling them out, and (ii) using filtering heuristics for the sake of efficiency. Generally (i) can lead to inefficient use of time and (ii) can lead to errors of omission.

[1] Performance data is presented for the Fund's Class A Interests and is net of any accrued incentive allocation, management fees, and other applicable expenses (as disclosed in the Fund's Confidential Private Offering Memorandum), include the reinvestment of dividends, interest and capital gains, and assume an investment from inception. Returns for month-end and year-to-date 2023 are estimated and unaudited. For investor-specific returns, please refer to your capital statements. Due to the format of data available for the time periods indicated, net returns are difficult to calculate precisely. Please see the last page for important disclosure information.

Past situations where others have misused filtering heuristics to dismiss what I have viewed as a great idea have led to some of the Fund's most profitable investments, such as KKR and RICK. Consequently, there is nothing I love more than hearing others write off an investment because of what I view to be poor logic. In my view, this is occurring with most of our current holdings, and especially with our two largest (IWG and DNTL).

Of course, throwing bad ideas out quickly without throwing out the good is a skill that must be constantly refined. Because of this, I am continuously trying to improve my mental model filters by adding sub-filters to them.

For example, consider an investment pitch I hear for a business that has an attractive long-term growth opportunity trading for 20x earnings. On its face, I might find it initially uninteresting. However, a cursory review reveals that it is trading well below tangible book value and that its current operating margins of 2% are well below the long-run average of 8% (more interesting). I then open a 10-K and see that 25% of sales come from a single large customer (less interesting). But I also read about the transformational acquisition the company recently completed to make it the largest, and by far most important, supplier to that large customer (more interesting). To finance the deal, they levered up significantly (less interesting). Using seven-year bonds at a fixed 5% coupon and no covenants (more interesting). The company is led by a CEO who joined when he sold his business for stock a decade ago, so owns 8% of the company today and has made numerous successful acquisitions since taking over (more interesting). Taking all of the above into account, it turns out the opportunity warrants a deeper dive.

These sub-filters are subjective and require creativity. Creativity helps investors look at each situation in various ways as they evaluate the many factors that could support ruling something out or continuing to work on it. Subjectivity is all about assessing the undesirable risks, some of which are present in every investment opportunity, and deciding whether the idiosyncratic return profile is attractive enough to compensate you for those risks. Of course, the end goal of using sub-filters is to improve efficiency while maintaining an open mind. I continue to refine the process with each year.

Open mind, existing positions: When thinking about existing holdings, it can be challenging for PMs to dispassionately assess new information as a situation evolves, leading to errors of commission. Whether the initial analysis on a name was right or wrong, there are always opportunities to modify prior decisions. However, in some cases, PMs suffer from *commitment bias*, which comes from pitching an idea publicly. In other instances, they stay the course due to *sunk cost bias,* after investing a significant amount of time and energy underwriting an investment. There are countless other investing biases, including *overconfidence*, *endowment effect*, and *herding* which cause investors to make suboptimal decisions about existing investments. Fortunately, I have been very comfortable changing my mind on existing positions over the years.

As I wrote in the "Learnings from our exits" section of the Q3'21 letter: "capital preservation is the Fund's number one priority, followed closely by compounding…when I am unsure of an investment, I will work to protect the Fund's capital first and deal with the rest later. My ego will not get in the way of doing what's right for the partnership. Many fund managers are hesitant to change their minds after publicly discussing a position because of the optics; I am not one of them."

Open mind, prior exits: Maintaining an open mind on prior exits is yet a third challenge for many PMs. Once a position is sold, investors tend to write it off in their minds. The typical thinking is that either "the easy money has been made," or the initial investment was a mistake, and the company is not worth owning. Having this mindset can be particularly damaging because the effort it takes to get up to speed on prior exits is lower than for a completely new idea, as are the odds of missing something material.

One of the exited positions discussed in the Q3'21 letter (referenced above) was Limbach Holdings (LMB), a holding that I was vocal about back then. Fortunately for the Fund, I did not write LMB off forever after selling it. I continued to follow the company and was able to act quickly to initiate a large position early in 2023 following a management change at the company that was significant. From reinitiation through year-end, the stock appreciated 4x and contributed to just over half of the Fund's gain for 2023.

For any investor, it is impossible to entirely prevent errors of omission or commission. However, the greats have no problem admitting when they are wrong. Instead, they take their losses, think deeply about what they could have done differently (if anything), and move on. They also keep an open mind as it relates to new opportunities and prior exits.

Of course, an open mind is like a muscle in that it atrophies if it is not exercised, especially as we age. I plan to keep working this muscle over time and hope that the Fund's process and performance can continue to improve accordingly.

Current positioning

At quarter-end, the Fund's top five positions were dentalcorp (DNTL), Enzo Biochem (ENZ), IWG (IWG), Limbach Holdings (LMB), and one undisclosed position that I am still in the process of building. Together, these holdings accounted for slightly more than 70% of capital. As highlighted in the Q3 letter, the Fund is more concentrated than it has been historically, as I believe the weightings are justified by the highly attractive risk-adjusted IRRs. There are also several other smaller positions and watch-list names that I am actively researching and am optimistic about but not yet ready to discuss.

Roll-ups

As I mentioned earlier in this letter, there is nothing I like more than seeing others write off an investment I own for what I view to be poor logic. Thus, I am naturally drawn to public market roll-ups, a type of investment that many investors immediately shun without much thought.

In fact, one of the Fund's most profitable investments to date is a public roll-up (RICK). Additionally, two of the Fund's three largest current positions are public roll-ups (DNTL and LMB). For this reason, I want to take a moment to explain why I am attracted to these models.

A roll-up is a business model that works to consolidate a fragmented industry via acquisition. By rolling up an industry, a consolidator can deploy lots of capital in a highly predictable way. In turn, this leads to increased scale and diversification, improved earnings quality, and a lower cost of capital. Additionally, a good consolidator can drive operational improvements at the businesses it acquires.

Unfortunately, there are many public roll-ups that have disappointed investors. Bad roll-ups overpay for acquisitions because they lack discipline or want to deploy capital quickly. They overpromise on synergies, as a way of justifying high purchase multiples. Because they overpay for acquisitions, their payback periods are extended, meaning they must eventually take on high leverage to keep on doing deals. Once the leverage gets too high, they run into balance sheet or cash flow issues and eventually blow up.

However, all of the above mistakes can be avoided by strong management teams. Good roll-ups focus on industries where there are many naturally forced sellers (those seeking retirement) and where there are fewer natural buyers. This typically leads to attractive purchase multiples. Good roll-ups are patient and willing to walk away from acquisitions if they can't pencil out attractive returns on actual numbers. Thus, they do not pay for synergies in the purchase price, nor do they rely on synergies to make the model work. Instead, they capture the synergy value creation for themselves. This leads to decent returns on acquisitions, faster paybacks, better free cash flow conversion, and minimal requirements to take on ever-growing amounts of leverage.

The two most common sub-filters I use when first looking at any roll-up are (i) add-backs and (ii) leverage.

(i) Add-backs: Do add-backs make up a substantial portion of adjusted EBITDA or adjusted FCF? Is there minimal free cash flow being generated since it is all going to pay for "one-time" integration costs?
(ii) Leverage: Are leverage ratios consistently moving in the wrong direction?

If the answers to the above questions are yes, I would need a special angle to keep working on the idea. Of course, with RICK, LMB, and DNTL those answers are no. I believe they are all good roll-ups and am excited to see how they all play out in the years ahead.

Outlook

Risk assets rallied to end 2023, as investors breathed a sigh of relief when central banks signaled that the worst of inflation and rate hikes were behind us. Personally, I am more comfortable when markets seem nervous rather than sanguine about macro risks. Obviously, with higher asset prices come higher expectations for positive economic outcomes. The risks of reaccelerating inflation, or delayed rate-driven demand destruction, have not gone away. Additionally, the 2024 election cycle is on the horizon. As we approach November, investors will have a wide range of policy outcomes to analyze.

At the same time, I believe that the Fund's holdings are attractively valued with attractive growth prospects regardless of how the economy performs in the coming years. If the economy and market remain strong in 2024, I am optimistic about the Fund's prospective returns. Should it turn out to be a year with above-average volatility, I am confident that it will lead to exciting new opportunities, which I will work to capitalize on for the benefit of the Fund. Regardless, I remain confident that the Fund's collection of businesses will continue to execute well and that, over the long term, we will be rewarded for good stock selection and patience.

Other Updates

Last month, I was featured in the Fall 2023 edition of the Columbia Business School's Graham & Doddsville newsletter. The interview was fun, but also an honor given that I have been reading their publication for over a decade. In it, I provide an in-depth overview of the firm's background, as well as my investment philosophy. I also discussed a few of the Fund's larger investments. If you haven't had a chance to read it yet, I encourage you to do so at your leisure.

At the beginning of 2024, the Fund changed its administrator to NAV Consulting. Partners should expect to receive their monthly statements on a more timely basis going forward. Please make sure to keep an eye out for monthly statements and K-1s from NAV going forward. All other communication will continue to come directly from Jessica or myself.

As always, I love what we own and am looking forward to updating you all on the Fund's activity and performance in the months and years to come. Thank you for your continued support and confidence. Please reach out with any questions.

Sincerely,
Yaron Naymark

Monthly Performance Summary[2]

2023	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
1 Main Capital Partners - Gross	14.1%	-0.6%	-0.7%	0.4%	-1.0%	8.6%	5.1%	8.5%	-12.2%	-0.4%	8.9%	18.5%	56.2%
1 Main Capital Partners - Net	13.9%	-0.7%	-0.8%	0.2%	-1.2%	8.5%	4.8%	6.8%	-10.9%	-0.5%	8.3%	14.8%	48.9%
S&P 500 index - incl dividends	6.3%	-2.4%	3.7%	1.6%	0.4%	6.6%	3.2%	-1.6%	-4.8%	-2.1%	9.1%	4.5%	26.3%
Russell 2000 - incl dividends	9.7%	-1.7%	-4.8%	-1.8%	-0.9%	8.1%	6.1%	-5.0%	-5.9%	-6.8%	9.0%	12.2%	16.9%

	One Year	Three Year	Five Year	Since Inception	Inception Annualized
1 Main Capital Partners - Gross	56.2%	32.2%	39.0%	364.3%	29.6%
1 Main Capital Partners - Net	48.9%	25.3%	31.2%	244.1%	23.2%
S&P 500 index - incl dividends	26.3%	10.0%	15.7%	87.3%	11.2%
Russell 2000 - incl dividends	16.9%	2.2%	9.9%	38.8%	5.7%

[2] Performance Data is presented for the Fund's Class A Interests and are net of any accrued incentive allocation, management fees, and other applicable expenses (as disclosed in the Fund's Confidential Private Offering Memorandum), include the reinvestment of dividends, interest and capital gains, and assume an investment from inception. Returns for month-end and year-to-date 2023 are estimated, and unaudited. For investor-specific returns, please refer to your capital statements. Due to the format of data available for the time periods indicated, net returns are difficult to calculate precisely. Please see the last page for important disclosure information.

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Past performance. In all cases where historical performance is presented, please note that past performance is not a reliable indicator of future results and should not be relied upon as the basis for making an investment decision.

Risk of loss. An investment in the Fund will be highly speculative, and there can be no assurance that the Fund's investment objective will be achieved. Investors must be prepared to bear the risk of a total loss of their invested capital.

Portfolio Guidelines/Construction. Information contained in this Report, especially as it pertains to portfolio characteristics, construction, profiles, or investment strategies or objectives, reflects the Manager's current thinking based on normal market conditions, and may be modified in response to the Manager's perception of changing market conditions, opportunities or otherwise, in the Manager's sole discretion, without further notice to you. Any target strategies, objectives, or parameters are not projections or predictions and are presented solely for your information. No assurance is given that the Fund will achieve its investment strategies, objectives, or parameters.

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