Dear Partners,

Askeladden Capital Partners LP returned in excess of ~ +41% gross YTD through 2019-09-30. This compares favorably to S&P 1000 Total Return performance of ~+17%. Since inception in early 2016, we have cumulatively returned ~ +186% gross, compared to benchmark performance of ~ +59%. On an annualized basis, that's ~ +32.3% and ~ +13.3% respectively. More details are provided in the performance table on the next page.

I'm here to talk about why none of that matters going forward.

As of the end of Q3 2019, Askeladden's total-strategy FPAUM (across the fund and SMAs) was roughly ~$13 million. This is up from ~$9 million this summer, and up from ~$3 million a year ago. Absent a substantial market drawdown, it is likely that when I write you again in several months, our capital base will be meaningfully larger than it is today. We continue to add new clients and receive additional capital from existing clients, in larger and larger chunks. I now believe it is likely that Askeladden will reach $50 million in committed capital and close to new investors within the next two years – if not sooner.

An obvious consequence of our rapid capital raising is that the majority of our capital base in 2020 and 2021 will not have significantly benefited from our strong returns since inception – or even our returns so far this year. Returns since inception, and the process that drove them, certainly played a role in attracting that capital base. They do not, however, tangibly benefit new clients, or new capital added by existing clients.

It is thus mathematically possible for us to look back, at some future point in time, and have strong-to-exceptional time-weighted returns – and yet be in a position where the majority of our clients earned mediocre returns on the majority of their capital invested with Askeladden. This is, in fact, perhaps the **base rate** for many funds: money-weighted returns lagging time-weighted returns, as various factors (complacency? **restricted opportunity sets?** fragmented focus?) contribute to star managers losing their shine over time.

Such an outcome would not be acceptable to us in any way, shape, or form. To some extent, of course, we have **structural problem solving** mitigants in place. From the beginning, I had a strong sense of intentionality in how I built Askeladden – I wanted it to be different. I invite comparisons to the benchmark and explicitly aim to beat it – not in any given quarter or year, of course – and thus we charge performance allocations *only* on outperformance versus the higher of zero or the index, over a three-year period.

Rather than believing ourselves to be a masters of the universe capable of earning alpha with any clients and any amount of capital, we've cultivated a client base that is aligned with our classic value investing philosophy, and frequently reiterated our intentions to close to new capital at $50 million in fee-paying AUM, to preserve our runway for investing in idiosyncratic small and micro-cap opportunities.

Rather than believing that we can successfully do everything, we continue to focus on doing one thing, and doing it well – identifying value investment opportunities in companies of good to great quality that trade for attractive valuations in absolute terms, allowing us to benefit from a combination of strong cash flow, reasonable growth, and positive multiple rerating over time.

This is a great place to start, but in the absence of motivation and focus, it wouldn't be enough. To this end, one of my favorite commercials of all time[i] is a joint Coca-Cola and Wal-Mart spot titled "Earn It." Please take a minute to watch it; I hope the story resonates with you as much as it does with me.

I've never expected anything to be handed to me; I've always expected to earn my keep. The balance of this letter is thus dedicated to how we intend to continue to "earn it" for all of our clients – current and future. We love our portfolio today and are strongly optimistic about the outlook over the next several years, but we're also aware that far-future returns are often earned from work we do today – so westward on we go.

Performance Table – *Please note: a prior version of this chart had a typographical error in the "ACP Seminet +/-" row under the "Annualized" column. It has since been corrected. All other lines remain the same.*

	2016 - Q3 19 Annualized	2016 - Q3 19 Cumulative		2016	2017	2018	YTD 19
ACP Gross	~ + 32.3%	~ +186%		+ 69.5%	– 1.8%	+ 21.7%	~ + 41%
ACP Seminet (Gross Less Management Fee)	**~ + 30.0%**	**~ + 168%**		**+ 67.0%**	**– 3.5%**	**+ 19.9%**	**~ + 39%**
S&P 1000 Total Return	**~ +13.3%**	**~ + 59%**		**+ 31.2%**	**+ 15.3%**	**– 10.3%**	**~ + 17%**
ACP Seminet +/– S&P 1000 TR	~ + 16.7 pp	~ + 109 pp		+ 35.8 pp	– 18.8 pp	+ 30.2 pp	~ + 22 pp
Outperformance Allocation: 30% of performance > MAX {benchmark, zero} every 3 yrs	~ – 4.7%	~ – 35%		– 10.7%	0.0%	– 6%	~ – 7%
ACP, Net of All Fees	**~ + 25.3%**	**~ + 133%**		**+ 56.3%**	**-3.5%**	**+ 13.9%**	**~ + 33%**
ACP Net +/- To S&P 1000 TR	**~ + 12 pp**	**~ + 74 pp**		**+ 25.1 pp**	**– 18.8 pp**	**+ 24.2 pp**	**~ + 15 pp**

DISCLAIMER: 2019 returns are unaudited; 2016 - 2018 returns are audited. Past performance is not a predictor of future results. We do not expect our future returns to approximate our historical returns. Amounts may differ due to rounding. Cumulative/annualized multi-year results may differ from individual year results given carry-forward provisions. Please consult your monthly statements from Fund Associates LLC or audited annual financials from Spicer Jeffries LLP for actual returns. Cumulative net returns are calculated assuming a hypothetical investor joined on the date of inception (2016-01-08) and paid the standard fee structure. For simplicity, we use 2016-01-01 as the hypothetical start date for fund returns on an annualized basis (which lowers our annualized returns, vs. actual.) Individual-year net returns are calculated assuming a hypothetical investor joined at the beginning of the single year, and redeemed at the end of the same year. Data is presented only for Askeladden Capital Partners LP and not for any of the separately managed accounts which Askeladden Capital Management LLC also oversees. Please see additional important disclaimers in the appendix.

Westward On: Where We Go From Here

It's important to understand that the world is **probabilistic** in nature; we can't fully control most of the important outcomes in our life – **luck**, or as some people prefer to call it, randomness, will inevitably play a role. As I've reiterated time and time again, I believe that we have benefited from significant luck since inception, and that we will not benefit from such luck over all time periods.

The existence of luck is, nonetheless, a poor excuse for succumbing to the siren song of nihilism. In substantially all areas of life, we have the ability to do at least something about our circumstances. Indeed, **agency**, the idea of free will or "belief behavior matters," is an empirically-demonstrated **causal** factor in success, however you choose to dimensionalize it.

The balance of this letter will provide commentary via **inversion** – identifying three of the critical, **80/20** type risks that could lead to our performance suffering in the future, and outlining how we intend to mitigate those risks. Some of the material below may have been covered before or elsewhere, but it represents our latest thinking as we approach the fourth anniversary of Askeladden's inception. It is of course not an exhaustive overview of every aspect of our process and thinking, but hopefully it at least level-sets, for everyone, how we approach the important task of allocating your capital effectively. We have tried to focus on the *evolution* of our thinking: what's different, rather than what's the same.

"We can't choose where we come from, but we can choose where we go from there.

I know it's not all the answers. But it's enough to start putting the pieces together."

– Charlie Kelmeckis, "*The Perks of Being A Wallflower*"

Risk factor: not having enough good ideas.
Mitigating factors: the watchlist.

Since inception, the investing environment has, on the whole, been *exceptionally* conducive to our process, as demonstrated by our strong returns, as well as our "reloaded" portfolio. Despite the market being at or close to all-time highs, not only is our portfolio fully invested, but we have more attractive ideas than we have room for, such that we are able to pick and choose the highest-quality, highest-return opportunities.

Our current portfolio-wide prospective return is around ~27%, despite strong gains so far in October – substantially above our underwriting threshold. It is at this attractive level without us taking excessive risk on any dimension we can identify.

For example: we do not have any position larger than 16% of AUM. We do not have much exposure to the price of any specific commodity. Over 40% of our portfolio derives a substantial portion of revenue and profitability from recurring, *multi-year* contractual revenue streams from creditworthy customers, such that even in a strong recessionary environment, revenues would be highly visible / predictable. We take very little leverage risk: 40% of our portfolio has either de minimis debt or net cash, and of the remaining 60% with some debt, only a small portion has more than 2x net debt to EBITDA (our threshold for starting to worry.)

We do not believe that any single geopolitical event – such as a meaningful currency devaluation, enactment of a particular regulation, or so on – would have an overwhelmingly negative effect on our portfolio as a whole. We have run portfolios in the past that are much riskier than today's; we would certainly be willing to do so again, but it is our hope that our watchlist will, over time, allow us to continue to optimize our risk/reward by providing an ever-growing set of potential investment candidates, giving us full and clear insight into actual, rather than hypothetical, **opportunity costs** of capital.

We have described our watchlist process extensively in previous letters, and thus will not review it here. What we will discuss: amidst a very strong year, one disappointment that stands out is that we have not grown the number of names on the watchlist very much in 2019; it remains stuck around 140.

There are several contributing factors. One is churn due to M&A, which is always a factor in small-cap land but seems to be particularly elevated over the recent past – off the top of my head, watchlist companies acquired since mid-2018 include KMG, TYPE, MAMS, PNTR, NCI, DFRG, and JMBA; there are more, but you get the idea. Similarly, as our quality standards have grown more stringent, other companies, particularly some of the lower-quality ones, have either been removed from our watchlist as they no longer fit our process (DTEA), or have succumbed to excessive leverage (KONA, WIN).

At the same time as these factors have seemed to accelerate the number of companies churning off the watchlist, the greater monitoring burden associated with our more diversified portfolio has also reduced the time available for us to conduct new research. Finally, an unusually volatile year has allowed us to take advantage of harvesting capital from existing positions, and redeploying it – for the most part – into positions already on our watchlist. The associated diligence for both updates and existing portfolio positions has often been quite extensive.

On the one hand, obviously our process is working just fine with the current watchlist. Returns since inception, and returns over the next year or two, will largely be the result of a watchlist the same size (or smaller) than the one we have today, and unless something goes terribly wrong, we think we'll be pretty pleased with our cumulative performance over the first 5 – 6 years.

If we (for simplicity) assume the watchlist stays at ~150 names in the near future, then at any given time, we can build a 15-stock portfolio from the lowest valuation quintile of the watchlist, with another 15 stocks to spare (that might not be interesting at the time, for whatever reason.) The current watchlist, with churn being replaced by new companies, would be perfectly good-enough to execute our investment process.

But we're not satisfied with good-enough: notwithstanding our year-to-date performance and our robust future performance expectations, we're disappointed in our slower-than-expected progress in building the watchlist. We view the watchlist as the equivalent of shots on goal or red zone possessions – the more you have, the better your chance of running up the score. Considering that we have a select handful of opportunities that are substantially more attractive than any others in our coverage universe, who's to say there aren't more like that out there, that we should know about and be looking at?

It's clear, at this point, that reaching 300 stocks on the watchlist (our original target) is unachievable over the medium term, and perhaps ever.[ii] 200, however, continues to seem like an attainable goal over the next few years. Meanwhile, we have some tangible steps we are taking to improve the efficiency of our research.

1) Quality over quantity. There have been times, in the past, where we have grown the watchlist much more quickly than we have today. But KPIs are only useful to the extent that they align with useful real-world outcomes, and doing research for research's sake just to boost the watchlist number isn't helpful if it doesn't lead to having more actually-useful investment opportunities.

   In some cases in the past, we went after research projects that were easy, for the sake of completing research projects, even if those projects were on the cusp of our quality thresholds at the time. With our quality threshold having steadily risen, we now choose to focus our energy more on companies that we actually have a higher chance of investing in.

   Although we've added fewer companies to the watchlist over the past year than we'd like, we feel very good about the ones that we *have* added; several have in fact entered our portfolio. We now are much quicker to immediately take a pass on businesses with characteristics we don't like (such as excess leverage, marginal business quality, or poor management.)

2) Selectively broadening our circle of competence. As a result of our efforts over the past few years, we are comfortable today in many more areas than we were at inception, or during our first few years. As one example, our work on Franklin Covey (FC) – not only on the company itself, but on a plethora of its publicly traded, subscription-business peers – has made us much more comfortable with evaluating subscription businesses, which are often very high-quality and sometimes deeply misunderstood. This understanding has manifested itself in a new position, tied for largest exposure in the portfolio, that bears strong similarities to where Franklin Covey was this time last year.

   Similarly, we initially had an exclusively U.S. focus, as we believed that we were ill-positioned to understand culture / consumer / governance differences that might make international markets different than our home market. We have since reconsidered to some extent. There doesn't appear to be much rational basis for being distrustful of governance or accounting in non-U.S. first-world markets. In fact, European small-caps often have much clearer and more comprehensive disclosures.

Similarly, in certain situations, cultural differences between countries are more cosmetic than real, at least for investing purposes. For example, enterprise software and the associated consulting services serve the same purpose in Italy, Norway, and Israel as they do in the U.S.; the value proposition, use case, and purchase analysis are essentially identical. Down jackets wear the same in New Zealand as they do in New York, and tollbooths work the same in Austria as they do in Addison, TX.[iii] While there are still risks like currency exposure that we have to consider, we do think that many international companies merit our research and attention; we've been pleased with positive initial results here, although our sample size is too small to be meaningful yet. More to come on this.

3) Reinvesting in research capabilities. As we scale, we necessarily lose certain advantages, such as being able to nimbly establish large allocations at a moment's notice without moving the market. However, a compensating factor – up to a certain point – is that going forward, we will have the ability to invest additional funds into extending our research capabilities. Certain tools or resources, such as access to data or other people's time, could enhance or accelerate our research process, and we have been starting to evaluate some options. We are still early in this process, and will report back when we have something tangible to discuss. We believe that our eventual at-scale asset base is the sweet spot between being small enough to invest in small/micro-caps, yet having enough resources to maximize the productivity of our research process.

   To be clear, we are very firm in our desire to continue as a one-man investment team; for reasons discussed thoroughly in previous letters and pitchbooks, I have no intention of hiring an analyst. This does not mean that we cannot benefit from others' expertise through a variety of formats (subscriptions, contract consulting, etc), and we intend to explore these possibilities fully.

4) Reinvesting in non-research capabilities. In addition to being Askeladden's portfolio manager, I am also the CCO and the COO. I write and file my own Form ADV update and place most of the trades. I am also my own tax preparer for my personal taxes.

   With all apologies to the Texas State Securities Board and the IRS, these are non-value-added activities for me to be spending my time on – compliance, trading, and taxes/accounting are undoubtedly extremely critical functions that any business needs to provide full attention to, but they are not my specialty. I'm good at research, and my time is best spent on that. There are competent, qualified professionals who – for a price – can handle areas that are not my specialty, in a manner that will not only result in higher-quality work, but will also keep my time focused on research.

Risk factor: mistakes of analysis or judgment.
Mitigating factors: margin of safety, finding the sweet spot between concentration and diversification, avoidance of leverage, focus on quality factors, differentiation between knowable and unknowable factors.

Assuming that we have sufficient opportunities to evaluate and act upon, the next critical risk that we face is whether or not our judgments on these opportunities are appropriate. We were recently asked by a prospective OCIO client if we think that our outperformance over time will be driven by the magnitude of our winners, or the frequency of our winners – i.e. are we running a VC-style portfolio where a few big winners drive overall performance, or are we running a bank-style loan book where we want to earn good returns very consistently on the overwhelming majority of our investments.

Our answer is definitively the latter. We have discussed before (Q1 2019) why, for a variety of reasons, we prefer to try to identify consistent sources of positive carry, thereby benefiting from the gravitational pull of cash flow and growth (and multiple rerating) over time, rather than trying to look for a few home runs. There are people who can execute the VC strategy well – I've known some – but I'm simply not one of them. I'm not looking for hundred-baggers; that's a bad **base rate.** I'm looking for two-baggers over three year horizons. The watchlist is designed to consistently surface such opportunities.

There are the standard, fairly trivial answers to this issue, and we'll get to them momentarily. One I'd like to highlight as different, however, is differentiating between what questions are knowable and unknowable.

To frame the issue, let's return to the issue of **luck** we discussed earlier. We do, strongly, believe in **agency** – making the right decisions consistently will result in better-than-average payoffs, given enough iterations. However, **luck** can interact with outcomes in funny ways, thanks to phenomena like **complexity** and **social proof.** Why is it that Even Spiegel is a billionaire? Why is it that some artists produce one-hit wonders from nowhere – then never compose anything else that catches people's attention? Luck, obviously.

Michael Mauboussin has some of the answers in *"The Success Equation"* (TSE review + notes). An important takeaway for investment purposes is that certain phenomena in the world are subject to unpredictable development. Here are a few real-world examples: sometimes new technology adoption is far more rapid than anyone expected – think about how Uber, AirBnB, and the iPhone went from nonexistent to ubiquitous over the course of a decade. In other situations, technologies that many people thought would become ubiquitous fail to have any discernible impact over similar time periods.

The implication is that not all assumptions are the same; modeling high growth in one situation might be very different from modeling high growth in a different situation. As a novice analyst, I failed to appreciate such nuances, and often made category errors, assuming that you could take the same approach to all companies in a certain bucket – i.e. all high growth is uncertain, or all businesses that look the same behave the same.

A tangible research takeaway is that if a phenomenon is fundamentally unknowable / unpredictable, more research isn't going to help. For example, although primary research is generally not part of our process, we do have friends who use primary research extensively. While they usually do a great job and find ways to extract value from it, we have seen some specific instances where they had a high level of confidence in a specific outcome, only for reality to be very different. This wasn't because they didn't do their work; rather, it's because they were trying to make accurate predictions about phenomena that are, fundamentally, very hard to predict – because the same set of initial circumstances can result in vastly different outcomes.

Better understanding nuances like these has allowed us to calibrate our investment process. In certain circumstances (such as levered companies), we have become far more conservative, and less willing to underwrite certain outcomes with any confidence whatsoever. In other circumstances (such as recurring-revenue businesses), we have become far *less* conservative, and far more willing to underwrite certain outcomes with a high degree of confidence. We have become more aggressive in underwriting *knowable* factors – which we can understand better through thorough research – and become far more conservative in underwriting *unknowable* factors – which we generally believe cannot be elucidated by research to a degree helpful for the investing process. When we aren't sure if something is knowable or unknowable, we like to default to "unknowable" for conservatism – **overconfidence** is killer in our business.

Nuances like these are what drive outperformance. On its face, value investing is easy: buy good businesses at good prices. But the day-in, day-out process of actually executing on that objective requires making nuanced distinctions on the exact nature of margin of safety.

Moving on, other changes to our portfolio management process include a somewhat less concentrated approach. While we still believe that as a one-man shop, it doesn't really make sense to have more than 15-20 positions, we also believe that running a 6-7 stock portfolio is an unnecessarily difficult, risky, and stressful way to make a living. Moreover, now that we have a fuller sample size, we've been able to observe that while our bigger positions have generally done better, the spread is not so meaningful that it justifies the risks associated with having, say, a third of our portfolio in a single position.

While not everything has been smooth sailing (of course), we generally have received acceptable-to-exceptional outcomes on the majority of our investments – so we now prefer to not take positions in excess of 20% of capital, and to instead give ourselves more shots on goal for our process to profit in any period.

Another evolution that we will discuss in the next section is a refining of our preference on taking cyclicality vs. leverage risk. One more for this section: our increasing focus on higher-quality companies, measured by metrics such as gross margins, Net Promoter Scores or other measures of customer value proposition, growth prospects, recurringness of revenue, and so on.

While we cannot speak for all investors everywhere, we now have clear and compelling data that our process works best for companies on the higher end of the quality spectrum. Although we've had good outcomes in both categories (higher-quality and lower-quality companies), all of the process mistakes we regret occurred in the lower-quality bucket.

As such, all other things (such as returns potential) equal, we now somewhat prefer higher-quality, higher-valuation companies to lower-quality, lower-valuation companies. Of course, we're still sticking to our roots: our entry prices still usually equate to high single to even sometimes double digit "owner earnings" yields. Compounder bros, we are not.

Risk factor: external "macro" challenges.
Mitigating factors: avoidance of leverage, caution around cyclicality, avoidance of single-factor Russian Roulette, focus on secular realities, focus on customer / stakeholder value proposition, and focus on "fairness."

Most readers are likely aware that we do not have any in-house market view; we do not attempt to time the market (or the economy) by tactically allocating our portfolio in light of prevailing and expected future unemployment conditions, interest rates, or market valuations. We aim to run an "all-weather" investment portfolio that focuses on secular rather than cyclical factors. We believe that A) most people cannot successfully time the market or the economy, and that B) even if some people can do so effectively, we cannot – it would introduce more noise than signal into our process, as we have discussed extensively.

This does not mean, however, that we have our heads in the sand about macro risks. Quite the converse. I am completely aware that, like many investors who came of age after the 2008 financial crisis, my experiences are not reflective of a full market cycle. Several of my mentors were fortunate (or unfortunate) enough to experience not only 2008-2009, but also the '90s tech bubble and subsequent crash, in real time. This taught them lessons that we, by proxy, can internalize into our process. We have intentionally cultivated relationships with such mentors to help us access more well-rounded perspectives.

One of our takeaways is that leverage doesn't matter until it's the only thing that matters. We've seen many investing write-ups over the past few years proclaim a company with 3 – 4x net debt to EBITDA to have a reasonable or even "strong" or "safe" balance sheet. Such investors are clearly from a different planet from us; anything above 2x gets our eyebrows raised, and anything above 3x is a big red flag.

Although credit conditions have been very favorable over the past decade, we've had the opportunity to observe, up close and personal, what it can look like when that ceases to be true – there are pockets, such as energy, where "extend and pretend" reached its limit. If you run into the wrong environment, 3x leverage can quickly turn to 4-5x, which can quickly turn into dilution or worse.

When Askeladden launched, our approach was equally cautious around cyclicality (and/or discretionary demand) and leverage: we viewed both of them as things that bothered us, but both were on equal footing. Although we remain equally cautious on cyclicality, we are far more concerned about leverage now than we once were (and we were pretty cautious to begin with.)

The simple reason for this is **path-dependency**. As we've studied more companies over time, what we've realized is that the two risk factors play out very differently for operating businesses.

For example, we've researched a number of companies with some cyclical/discretionary component to demand, that went through setbacks. Some of these were companies that saw some decline in demand in 2008-2009 due to reduced consumer and business confidence; others of these were companies that saw specific industry down-cycles (rail, energy, etc) that led to more severe reductions in demand.

There are obviously different circumstances – sometimes demand goes away and doesn't come back – but, for illustrative purposes, let's restrict our discussion to durable sources of demand that may be deferred, but don't go away. As merely one example, people will always want to eat, buy clothes, and entertain themselves. They may trade down or defer some such experiences during recessions, but over the long term, we can be confident that this demand will be reasonably consistent.

In such cases, industry slowdowns can actually be a long-term *boon* to well-capitalized companies. Marginal or levered competitors may defer investment or go out of business entirely; well-capitalized and well-run companies can take advantage of this void by investing in new products and locations, by poaching customers from competitors who are underinvesting, etc. Good companies will, too, suffer from the slowdown in demand, but they often emerge stronger – and at the very least, the slowdown does not typically strike them a terminal blow. In other words, macro challenges are annoying, but not fatal.

Leverage is different, because it introduces path-dependency. Demand may come back, but if it comes back after your debt is due, it's game over. We've actually seen many cases where leverage didn't *outright* kill a company, but sort of killed it in slow motion.

For example, in several different industries, we've seen software leaders acquired by PE and then run for cash. In the process, they underinvested in R&D, leaving open a doorway for smaller competitors to take share. Then they end up in a catch-22 situation – they can't increase R&D because the cash flow is needed for debt service, but they can't maintain their cash flows, let alone generate organic growth, without remaining competitive on their feature set. Value destruction is likely either way, whether it's a slow burn or a quick blow-up.

So while we don't want our *entire* portfolio to be exposed to businesses with the potential for cyclical declines or deferrals of demand, and we thus keep track of this exposure top-down to make sure we're not setting ourselves up for the worst, we're also more comfortable with this risk than with leverage risk.

Another mitigating factor, partially referenced a few paragraphs ago, is a focus on secular trends that, in the long term, are more important than near-term fluctuations. We believe that many investors incorrectly emphasize the cyclical, when they should be emphasizing the secular. For example, for most high-quality software/technology companies we've studied, 2008-2009 is an irrelevant blip in a long and distinguished history of growth. Moreover, there are two separate software/technology companies in our portfolio that have a decade-long track record of strong growth despite a high level of exposure to basket-case economies (one of which is Italy, to give you a sense of the headwinds they're fighting). This is not to say that they would prosper equally in all environments; obviously they will do better when their customers do better. But it is a universal truth that we will use more technology tomorrow than we do today; over any meaningful investment horizon, that truth is far more important to the progress of specific companies we track than more temporary factors like the state of the economy, or which political party is in power.

Speaking of political parties, regulatory / political risk has been an increasing focus for many investors over the past year, as tweets have turned into tariffs in the current Trump administration, and hard-line pro-regulatory (Medicare for All) and pro-labor ($15 minimum wage) stances have been bandied about in the Democratic debates.

Discretion being the better part of valor, I deleted a more comprehensive discussion of how we're approaching some of these issues, as my experience with **ideology** has taught me that I'd make some portion of my client base unhappy no matter what I said. Suffice to say that ideas proposed by both political parties would positively and negatively impact different portfolio companies in different ways.

We generally tend to focus on situations in which these risks are manageable and marginal rather than total; we avoid healthcare, for example, given the fact that it seems profit streams can be legislated out of existence at a moment's notice. We are not experts on how to price this sort of binary risk, so we avoid it. There are other binary risks – like tax rates – that are somewhat easier to price (at least in the sense that you can very easily keep track of what companies would be worth under a different tax regime.)

Although we don't intentionally optimize around this sort of variable, through the diversification that comes with having a broad opportunity set, we feel like we'd be relatively well-insulated from any specific regulatory decision like increasing corporate tax rates, or restricting the domestic energy industry. We think about factors like these and try to avoid playing Russian Roulette – i.e., we don't like playing games that can kill us. So, for example, the potential for fracking regulations is merely one reason (another being oil prices!) that we keep a close eye on our direct and indirect energy exposure.[iv] We never want a single uncontrollable external factor to wreck our returns.

One unique angle we will point out, with regards to avoiding politically-oriented macro risks, is **fairness / stakeholder value.** Much has been made of the recent shift in corporate focus from "shareholder capitalism" to "stakeholder capitalism," backed by top CEOs as well-respected and profit-oriented as Jamie Dimon (not exactly Public Hippie Number One). Although this is not an approach that I would always have agreed with, it is one I've increasingly come around to over time: I'm generally very skeptical of investing in companies that I believe are exploitative – regardless of who it is they're exploiting.

The most frequent angle in which we conduct such analysis is customer value proposition. We categorically do not invest in companies such as tobacco companies (which kill their customers), or companies such as timeshares and Herbalife-style MLMs (that, in our opinion and that of many others, charge their customers far more than the value provided in return.) Even absent our general avoidance of healthcare, we would not, similarly, have wanted to invest in a Valeant or Turing-like company that was raising the prices of critical life-saving drugs by orders of magnitude for no tangible reason other than to enrich shareholders and executives.

Setting aside our moral compass, we believe that there is a compelling mental-models based rationale for avoiding such companies: **fairness.** Fairness, as Richard Thaler explains compellingly in *Misbehaving* (M review + notes), is among the enduring human behavioral traits long ignored by economists (and MBAs). [v]

People generally have a strong intuitive sense of what is "fair" and what is "not fair," and even if something is reasonable/rational, it is unlikely to be sustainable if it doesn't pass the fairness test – because people generally revolt when they feel they're being treated unfairly and getting the short end of the stick (this is what Charlie Munger calls "deprival superreaction syndrome.")

Such revolt can take many forms. Customers who don't feel like they're getting a good deal may defect to a competitor, or – worse for the business – may seek regulatory remedy if they feel they are being treated particularly unfairly. Conversely, of course, businesses with extremely strong customer value propositions and happy, high net promoter score customers are unlikely to face lots of regulatory backlash, or, for that matter, disruption. In any event, serving rather than exploiting customers is better for business.

Of course, fairness doesn't just apply to people who a company serve, but also those who work there. While, as Office Space demonstrates to great effect, every workplace is probably going to suck in some ways, there is a line between usual job frustrations and employee exploitation.

Even as a born-and-bred Texan capitalist, I find it difficult to read about unpredictable scheduling and think that there's anything "fair" about it: it is one thing for a business to pay someone an agreed-upon hourly wage for their time, and quite another for a business to hold *all* of someone's time hostage but only compensate them for a small fraction of that time. I think that setting ideology aside, most rational people can agree that we would find such behavior fundamentally unfair, were we on the receiving end of it. And behavior that is near-universally perceived as fundamentally unfair eventually tends to get punished by the authorities.

Many of the companies we invest in, by the nature of what they do, require high-dollar specialized talent and have appropriately-designed incentive schemes and positive corporate cultures to make sure that people participate in the value they create. Other companies, however, do employ a higher proportion of low-wage employees, and – by and large – we have found that although we do not explicitly optimize for this factor, most of our companies tend not to be at the bottom of the barrel when it comes to employee compensation and work environment.

This may be because of the "1 Great Employee = 3 Good Employees" philosophy espoused by Kip Tindell in his memoir, *"Uncontainable"* (UCT review + notes), about the history of The Container Store. Again, setting aside warm-fuzzies, paying employees more can be good business, i.e. profit-accretive, if it results in better talent and better motivation.

As a result, even though – again – we don't explicitly optimize for companies that would not be subject to additional regulatory oversight, we feel that our portfolio is *generally* not overly-exposed to negative impacts from increased regulations. This isn't to say that certain policies implemented by certain candidates wouldn't have a negative impact. It is to say, however, that our investment process is, on the whole, designed to deliver performance *regardless of such factors;* we don't want to be like those companies that would have reported good results, *except for the weather.*

For example, over the last several years, many of the companies on our watchlist and in our portfolio have been negatively impacted by tariffs. Undoubtedly, our performance would have been higher – as would that of the market – had the administration not taken such a hard-line stance on tariffs. Of course, on the converse, our returns – as well as those of the market – have received a one-time boost from the cut in corporate tax rates, which could perhaps be reversed in the future. Such an event would undoubtedly harm our returns, but it should not be used as an excuse. The whole point of margin of safety and value investing is to deliver strong returns over multi-year time horizons *despite* such circumstances. We can't control our mark to market over any short-term time period, but we're highly confident that given enough time, our positive-carry focus will shine through.

Conclusions

The next time I write to you, Askeladden Capital will be four years old. In many ways, building a business has been different than I'd ever imagined.

But in the most important way, it's been exactly the same: I can't think of anything else I'd rather be doing with my life. Running this business uniquely enables me to live my best life, which is one of the primary motivators for making sure I do my best to leave it all on the field. We've come a long way, but there's even farther to go, and lots of work still left to do.

A sincere thank you to each Askeladden client for entrusting us with your hard-earned capital.

Westward on,

Samir

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[i] Puppy Love is actually my favorite commercial of all time. Obviously. But it's excluded for our purposes here because, c'mon. Puppies are basically cheating.

[ii] An obvious mathematical problem is that at some size of watchlist, churn from M&A will match or exceed our ability to continue to add new names. Using some dumb fake numbers, let's say that on top of portfolio monitoring and updates on high-priority investment candidates already on the watchlist, we can add two to three new ideas per month on a gross basis – 2.5 on average, or 30 per year. However, churn is a function of watchlist size – it is reasonable to assume that M&A and other sources will eat up some percentage of the total watchlist every year. If this number is, say, 5 – 7%, then as the watchlist grows, our net adds will not only drop in *absolute* terms, but will also drop even more meaningfully in *percentage* terms.

For example, at a current watchlist of ~140 names, perhaps we could assume we will lose 7-10 per year to M&A. A reasonable net add number is, perhaps, 20 – 23, or ~15% growth in the size of the watchlist.

However, at such time as our watchlist were to grow to ~250 names, churn would then account for 13 – 17 losses. Net adds would therefore be perhaps only 15 per year – or a far more paltry 6% adds.

The takeaway here is that the bigger the watchlist gets, the harder it is to grow; when I was starting from zero, there were very few stocks to update on, and very modest churn given the small size of the list, so it was easy to grow the list rapidly. As the list gets bigger, there is more maintenance and more churn, which makes it harder to grow. This is the basis on which I am placing more emphasis on quality – if net adds are increasingly precious, then we shouldn't give ourselves latitude to put "meh" ones on the list simply for the sake of having them on the list.

[iii] As J.K. Rowling once said, I'm dropping anvil-sized hints here…

[iv] There are, of course, nuances here – midstream/downstream vs. upstream, global vs. U.S., ongoing/recurring operational demand vs. short-cycle demand levered to fracking completions, etc etc. You get the point, though.

[v] Thaler, I believe, clarifies or strongly implies that chief among the groups of people who don't understand fairness are MBAs and MBA students. *"Gouge, baby, gouge!"*

Appendix – Important Disclaimers

Please note that YTD figures are estimates based on our brokerage statements – they do not factor in nuances of the accounting for performance allocations that is performed by our fund administrator – hence our use of the tilde "~" to represent that results are estimated. Gross returns from inception through 12/31/2018 are audited. YTD 2019 returns are unaudited; however, results that we report are rounded down from official statements provided to clients by our fund administrator.

SMA clients should also note that the returns discussed in this letter are only for Askeladden Capital Partners LP, and individual SMA account performance may vary due to tracking error, account parameter restrictions (such as international trading permissions), and other such factors. Fees are also reported for an investor paying the standard fee structure; investors paying a different fee structure (such as non–qualified clients to whom we cannot legally charge a performance fee) will obviously have different results, whether they are SMA clients or LPs of the fund. As such, please consult your own account statements to determine your individual account performance.

Moreover, please also note that investors in Askeladden Capital Partners pay a variety of fee structures – including my own capital, which pays no fees, and non–qualified clients on whose accounts I cannot legally charge performance fees. This means that Partnership–wide audited returns reflect a variety of fee structures, and this fee structure on average (factoring in, for example, my account not paying any fees at all) results in partnership–wide fees being materially lower than the stated fee structure.

Therefore, I believe it would be misleading to report the Partnership's actual audited net returns in the table above, as they would materially overstate the returns that would have been achieved by a client paying the standard fee structure. As such, instead, in these letters, I report fees for a hypothetical investor paying our standard fee structure. Cumulative net results in the table above are thus materially lower than actual audited net results, but, in my estimation, substantially more useful for analytical purposes. Investors with any questions are welcome to review our audited financials for 2016 – 2018.

Past performance is not a predictor of future results. We do not expect our future returns to approximate our historical returns. Amounts may differ due to rounding. Net returns are calculated assuming a hypothetical investor paid the standard fee structure of a 1.5% annual management fee and 30% of the outperformance, if any, vs. the S&P 1000 Total Return index, which was chosen because it had, at the time of inception, historically outperformed the Russell 2000 and most accurately represents our typical investment universe of small and mid–capitalization U.S. equities (i.e., those with a market cap of $10 billion or less). We may invest outside this universe (for example, in U.S. large caps or international small caps.)

This is not an offering of securities or solicitation thereof; any offering of securities would only be made to accredited investors via a Private Placement Memorandum under Rule 506(c) of Regulation D, and any prospective partners who did not have a pre–existing relationship with Askeladden as of 1/18/2017 would be required to verify their accredited status with relevant documentation. This requirement does not apply to separately managed accounts. Any documents prepared prior to 2017–01–18 were not intended for public distribution and should be read accordingly. Askeladden Capital Partners, and SMAs that mirror its strategy, should be considered high–risk investments suitable for only a small portion of an investor's overall portfolio, as they involve the risk of loss, including total loss. Specific risk factors are enumerated in our Form ADV.