



Dear Partners,

Things can change pretty quickly. When I last wrote to you, I somewhat uncharacteristically mused about the market environment, where anything that looked like primo material for Cathie Wood to buy just went up, up, up every day, regardless of fundamentals, valuation, or anything else. Our portfolio, meanwhile, remained somewhat downtrodden, as many names languished despite reasonably strong results, considering the environment.

A quarter later, the reverse has happened. As ARKK has found itself unPLUGged, our portfolio has done very well – the headline is probably the buyout of Marlin Business Services (MRLN) for a substantial premium to our cost basis. Across the board, the first four months (and counting) of 2021 have been very kind to us. After lagging the market for all of 2020, we are now back ahead of our benchmark, the S&P 1000 Total Return, on both a gross and net basis since the start of 2020 (albeit only very modestly, which I continue to work to correct.)

In fact, if you simply took our portfolio valuation today, and at the start of 2020, without any of the interim data points, you might conclude that we'd had a solid 16-month stretch – in reality, not so much, of course; we had a nasty drawdown. To us, this simply highlights the need to continue to focus more on company fundamentals than on day-to-day market performance (harder said than done, obviously). Although there are definitely things we could've done better during COVID – as I have discussed previously – we didn't feel we deserved the severe underperformance we were faced with, as most of our businesses were doing very well fundamentally.

In 2021, that has now corrected itself, though we of course continue to believe the portfolio is undervalued. Where to from here? We always hope higher, but we'll see. All we can do is continue to apply our process – everything looks easy in hindsight, but is anything but obvious ahead of time. *The past is only the future with the lights on.*

This letter will be rather brief; I will start by discussing the focus of our current research efforts, then briefly discuss why I won't be investing any more capital in Askeladden over the next couple years.

What If I Say I'm Not Like The Others

COVID was a frustrating environment in which to be a bottom-up, individual-security-focused fundamental investor, because – at least temporarily – individual company fundamentals were often rendered irrelevant by issues that spanned multiple sectors. Whether you were the best-run airline/restaurant or the worst, you had to contend with a 12-18 month period of severely depressed demand that was entirely out of your control.

Now that we're coming out of COVID, however, we've been trying to use this to our advantage. Over the past six months, our research efforts have been primarily focused on playing the elementary-school game of "which of these is not like the others." Think of it this way: throughout the past year, there have been, of course, a range of reasonable expectations regarding when and to what extent the world will "go back to normal," and what that would mean for companies (or entire sectors) positively or negatively affected by COVID.

At times, due to different investor demographics in different sectors or portions of the market, the market has been wildly inconsistent about what expectations it uses. This creates the opportunity for earning excess profits for the same unit of risk taken – and we view it as a very profitable (albeit one-time) vein of opportunity to mine.

For example, by late 2020 and early 2021, the market capitalization and/or enterprise value of many highly COVID-affected companies in sectors such as travel or restaurants had approached or exceeded pre-COVID valuations, suggesting that investors in these companies believed in a relatively full and quick "return to normal" where people would once again eat out and go on vacation.

Yet due to its illiquidity and small size, small-business lender Marlin Business Services (MRLN) was available as recently as a month ago at a significant discount to its tangible book value, despite a credible history of strong growth at attractive, value-creating ROEs. As we discuss in more detail in the portfolio commentary, the company was recently acquired for a significant premium – an outcome we thought was likely eventually, albeit not this



quickly. We're happy for the quick win, which we think is another feather in the quiver of taking a few more positions than we have previously (as discussed previously, we seem to have this happen to one or two positions per year – we just never know which one or two.)

On the other side of the spectrum, many beneficiaries of COVID saw their market capitalizations soar to new heights – but Sprouts (SFM) was available as recently as two months ago for prices equivalent to pre-pandemic levels, despite windfall profits during COVID, and positive long-term changes to their business model, because grocery investors are apparently too myopic to care about anything other than comps.

In addition to adding to our position in Sprouts, we've invested in two European-based companies that are new to us, in the travel and software sectors respectively, that seem to be long-term beneficiaries of COVID-induced changes, and have engaged in beneficial restructuring of their own businesses that should increase long-term profits, yet trade at similar or lower than pre-COVID valuations. This is perhaps due in part to a slower vaccine rollout in Europe and (consequently) worse sentiment in those markets, even though the businesses in question are multinational and have a fairly similar global profit mix to many U.S.-based companies that have rallied substantially.

We've also invested in one U.S.-based marketplace company that has been on our watchlist for years, facing meaningful COVID-related headwinds, which should abate over the coming year as the world normalizes.

As the world rapidly returns to normal, we think that these one-off “recovery play” ideas will come to a close. Which is fine, and somewhat welcome – it will be nice to be able to go back to an analytical framework that makes no special considerations for COVID (and indeed, a world that makes no special considerations for COVID.) Immediately prior to COVID, we were trying to create a more structured and programmatic “research pipeline” by identifying and prioritizing the addition of businesses to our watchlist which *looked a lot like* businesses that we had historically had success with. We have a number of dormant previously-identified research candidates to get back to, and I think the absence of COVID and other distractions will be helpful in dramatically increasing our productivity in the back half of 2021.

Diversifying Personally

I previously discussed my intention to diversify the Askeladden portfolio; this time I'll discuss my intention to diversify my personal portfolio. I'd like to quote from an interview of my friend Jim Roumell in a recent edition of [Value Investor Insight](#), which I thought was very insightful. Quoted with permission:

JIM ROUMELL: We recently decided to increase our level of portfolio concentration, taking full equity positions from 3% to 6% in size to more like 5% to 10% [...] the genesis of that was hearing from investors that they invest with us to find small out-of-favor stocks and spend the time and effort involved to figure out if those stocks are mispriced.

If we do that well – and our investors are counting on us to do that well – why not express our conviction through bigger positions? As the conversation went further, I realized that the primary reason I managed the portfolio the way I did was because the majority of my net worth was in it.

It obviously makes sense that portfolio managers should have skin in the game, but my having more than 50% of my total net worth in the portfolio put me in a very different place risk-wise than my investors who only had maybe 5% to 10% of their money with me – money that was specifically earmarked to invest in small off-radar stocks.

To get in better alignment from a risk perspective – while still having plenty of skin left in the game – I've committed to keeping one-third of my net worth in the fund. [...] It all makes more sense for how we invest, and it's actually been quite liberating for me to act more fully on conviction when I have it.

This echoed thoughts I was already having. Since inception, I've had essentially the entirety of my net worth invested in one of the three following ways:



- invested in Askeladden Capital Partners LP,
- invested in my PA (for personal liquidity purposes) in the same stocks currently or formerly held by the fund, or,
- invested in operating the business.

I've always believed, conceptually, that some value investors have a rather extreme view of alignment of incentives. In some circles, "best" is considered to be when a CEO draws no salary but only owns stock, or when a fund manager draws no management fee or invests 100% of their net worth in their strategy.

A full discussion of my disagreement is beyond the scope of this letter, although I've touched on some of these points before: it is not in the nature of most human beings to make optimal decisions when they are drawing down savings to pay bills, or seeing their income, net worth, and reputation all trend down and to the right. Obviously, we're coming from the opposite direction as Jim in some sense, as we have recently *reduced* our concentration, although we seem to have ended up in the a similar place (7-8% core position size). But I think the path of becoming more conservative as you get older is well-trodden, and likely quite rational.

I see it like this: when you're early in your career, you A) generally have few assets to begin with, and B) have a long period to earn more and invest more. At this point, the amount of money defined as "life-changing" can be rather small: if you save enough in a few years to make a down payment on a house, or to quit your job and start a business, or etc etc, that will really positively benefit your life. It makes sense to swing for the fences at this point in your career – the benefit of accumulating some wealth to improve your life or open up options for you is far higher than the risk of losing half or all of a very small amount that you will make back quickly, anyway.

As you get older, and particularly once you have fixed obligations like a mortgage, and kids relying on you for their supper, the risk calculus shifts quite substantially. My parents went through multiple periods of significant financial stress when I was growing up, a large part of my motivation to ensure I never find myself in the same place.

Now that I have a reasonable level of financial security, it's far more important to me to *maintain* that standard of living for my future family, than it is to compound my (personal) capital at the highest possible rate of return. For example, a la Charlie Munger, I'd like to have a ridiculously large pile of cash *personally*, to hedge against the most catastrophic bad outcomes, no matter how inefficient that may be from a returns perspective – yet as I've discussed before, I also think the opportunity cost to holding too much cash on behalf of clients is simply too high.

There's obviously not much I can realistically do to diversify my sources of income; even if I could, it would likely result in meaningful conflicts of interest with clients. But there is something obvious I can do to diversify my *net worth*, and ensure that a bad year or two for our strategy doesn't mean such a bad year or two for *me personally* that it becomes an overwhelming, fight-or-flight issue. Our concentrated small/micro-cap strategy has a proven track record, but comes with inevitable volatility and drawdowns (see: 2020). For the strategy to work, I have to have the conviction to swing hard when particularly attractive opportunities arise, and not be scared of adding to positions at fire-sale prices when everything is very scary indeed.

The thing I regret most about the COVID era is not really any individual decision specifically, but more my general state of being throughout the year. To say I was not my best self would be an understatement. Few of us were, of course, but crises demand excellence, and I'd grade my performance as merely "OK" – not excellent – despite the fact that I was still in the very fortunate position of not having anyone depend on me (which will obviously change over the next decade). 2020 took a tremendous personal toll on me, and I can't imagine how difficult it would have been had I been 10 years in the future with a young family to support.

Investing is an emotional endeavor as well as an analytical one. I intend to do better next time, and I think one correct step is to ensure that my personal balance sheet does not move up or down in lockstep with Askeladden's mark-to-market returns. During COVID, I doubled down (personally) on our holdings, investing essentially all of my cash savings either into the fund or into the same stocks we owned – but there may come a day when I in fact



needed to create rather than invest cash during such a crisis. It would certainly be far better for me to be able to view drawdowns with excitement (i.e. as opportunities) than with frustration (i.e. as a threat), which is exactly how they're going to be viewed if 100% of my investable assets continue to be invested in Askeladden.

Of course, I am in a different stage of life than Jim, and as such am not quite so risk-averse. I'm still completely comfortable with having 50%+ of my invested (i.e. non-cash) net worth in Askeladden, although I don't have a particular target or timeframe for how much I want invested in the fund (other than "a lot.") To be clear, I don't plan to reallocate any capital invested in the fund to elsewhere; when I wind down the partnership (more to come on that soon), I will simply transfer all my holdings into an SMA that is managed *pari passu* to all other clients. Rather, I simply plan to use incremental cash flow in 2021-2022 from the business to diversify my personal portfolio.

As far as the *how*, I'm not exactly sure. It's clearly not a good use of my time to try and manage it myself. I'm aware that index funds are the correct choice from a statistical base rate perspective, and that market timing is a fool's game, but I can't really bring myself to buy the S&P 500 (today, anyway), let alone the R2K (which would not make much sense from a diversification perspective, of course). So, in lieu of indexes, I have made a few small investments in mostly blue-chip large-caps in a fairly unsophisticated, retail-investor type of way, i.e. without any serious analysis (as strange as that may sound), and plan to make a few investments in funds run by people I know and respect. The point is diversification rather than maximizing returns. My focus needs to be on stocks Askeladden will invest in – not on managing my PA.

This is where I turn to you: the benefit of having thoughtful clients is that many of you have already identified and vetted other investment managers in other verticals who have unique talents, perspectives, or opportunity sets that I do not. I'd like recommendations – with the obvious caveat that at least for now, I can't make particularly large investments. That probably closes me off to a large portion of the universe, but perhaps makes me perfect for emerging managers or funds with niche opportunity sets like Askeladden.

With a few exceptions (i.e. very well-established and well-regarded funds, or unique private equity vehicles – one of which I am very sad is not accepting capital right now), I am generally strongly biased against limited partnerships and towards separate accounts. I'm perfectly happy to trade off other factors for certainty that I'll *get my money back*.

Just in case there was any doubt, this doesn't represent any lack of conviction in my investment approach, nor should it be interpreted as me being less invested in the success of Askeladden. Quite the contrary – I simply see a future where having 100% of my capital invested in Askeladden is likely to lead to a worse outcome for clients than me having a more balanced and diversified personal investing approach.

Conclusions

All the pressure of the past year was imposed either by myself, or the world at large, but not clients – we are very fortunate that clients, on net, have added substantially more capital than they have withdrawn over the past year. Despite continued inquiries, we remain closed to new clients, and are only taking agreed-upon amounts of capital from existing clients. We greatly appreciate the continued support and endeavor to do our best to grow your capital.

We continue to believe that we are in the sweet spot – we now have plenty of resources such that I can invest in value-added services (like Tegus), but remain small enough that we are not liquidity-constrained in being able to invest in compelling micro-cap opportunities. Although it's not a figure we specifically optimize for, 70% of our portfolio is invested in companies with a market cap below ~\$520 million USD – companies which many larger funds can't even look at, let alone buy in conviction size.

Westward on!

Samir