Tissot Ayram Family Partnership

Dear Partners,

Gross returns for Tissot Ayram Family Partnership in 2017 were as follows:

Partnership 1	*Partnership 2*	*Partnership 3*
12.62%	*20.75%*	**7.33%*

** Partnership 3 was initiated in October 2017.*

2017 marked the end of our fourth year together. While we are small and our partnership consists of only a handful of people, I want to immensely thank each of you. Your support, trust and commitment have made this family partnership real, and I can tell you that I do tap dance to work. Special thanks to Laura, my partner, who helps me enormously with all my projects and keeps me focused. Without the right partners, my work would be vastly more difficult. Nothing makes me happier than to compound your capital along with mine. While life is not linear, and we will have periods where clouds gather over the market or over our individual companies, I am pleased with our results for 2017 and for our four years overall.

(Gross) 2017 returns and returns since inception are as follows:

Year	*Partnership 1*	*Partnership 2*	*Partnership 3*
2014	*12.47%*	*15.00%*	
2015	*-8.32%*	*-3.15%*	
2016	*63.42%*	*65.89%*	
2017	***12.62%***	***20.75%***	****7.33%***
CAGR	*17.37%*	*22.22%*	

** Partnership 3 was initiated in October 2017.*

The fee structure follows Warren Buffett's fee structure of his initial partnerships.

<u>Overview</u>:

<u>Technical (only for Partners)</u>:

I created each partnership with a different partner because of a mandate in place with one partner in which said partner would not own Colombian stocks or penny stocks. In October 2017, we welcomed a new partner, and partnership three was born. At present, they all hold nearly the same companies and results are going to be similar among them, although shifts in position can occur. For the purpose of information on the alignment of interest ("Skin in the Game"), the vast majority of my net worth rests in partnership 1, as I would never buy an asset for you that I would not buy for myself.

Partnership 1 (P1), which has a gross four-year CAGR of 17.37%, returned less compared to partnership 2 (P2) with a gross four-year CAGR of 22.21%, due to P1 having held Colombian stocks and penny stocks that P2 did not hold. The performance of the Colombian stocks and penny stocks fully explains the underperformance of P1 compared to P2.

<u>Non-technical</u>:

Dude in a garage with an internet connection

When I began on the value-investing journey, one of my sources of knowledge was other investors' letters; I read as many as I could get my hands on. I did not know much about many of those investors then, and those letters provided an extraordinary way to learn about different investment styles and discover investment ideas or additional reading material. Thus, I create this letter not exclusively to my partners, as I think my small experience can benefit others. It is a way I can give back what I regularly get from many investors who have no idea how much they have helped me with their writings.

My 2016 annual letter was published on Reddit and I recently saw that one reader asked, "Who is that guy?" Another user commented, "dude in a garage." That answer is pretty accurate (slight differences), and I am proud of that. Let me elaborate. I run a familial partnership where my partners are family members who put a huge amount of trust in me. That is the reason there is no website or promotional material. I have the best partners and I spend my time trying to allocate capital the best way I can. I work from a National Library, from home, from the premises of a business I own with my girlfriend and, occasionally, from co-working spaces—so indeed I am a proud dude in a garage!!

Before I begin, I want to deeply thank Sam, Ian, Mike and Danny—We all met in New York in 2015 and I think there has not been a single day since when we have not gotten in touch and communicated. We are all value investors with skin in the game and with very different styles, which has brought me immense learning and adventure. I am very grateful we met and have such a wonderful group.

Part 1

Was Plato a Value Investor? – How you should disclose your investment time horizon? – Back to Biology classes

"I've no control over returns. I can control savings. I've no control over outcome. I can control process. I've no control over markets. I can control behaviour." – Found it on Twitter

Since the day I started the Value-Investing journey around five years ago, I found that a lot of us Value Investors get inspired by our shared heroes—we read what they write, study what they have done, try to find patterns and love quoting them (as I just did above from Twitter and will keep doing).

We are very good at the latter, but sometimes our actions divert from what we say, which can lead to quoting fatigue. I spent a lot of time thinking, trying to see what aspects of our actions were not matching up with the advice of our heroes.

I came to the conclusion that the majority of us do not behave the way we should at investing, and that is the major difference between us. Some of us can be very smart, but if we let emotions dominate us, they will drive our future behaviour and influence our decision-making process, and then it becomes irrelevant how smart we are. But this being said alone, without real actions, is a platitude. Therefore, I will explain what I am actually doing in the real world to deal with that.

After evaluating in detail my mistakes, I found that indeed my behaviour was the main cause of them. I also found that I made a lot of correct decisions while making a conscious effort to behave well.

Let me give you two examples:

- *Mistake*: In December 2016, I was reading a book called, *What I Learned Losing a Million Dollars*. I was just approaching the end of my best year so far, and this book was supposed to help me keep my feet on the ground. At that time, the price of Avianca (the Colombian airline) reached my estimate of value, and I should have sold. However, I believe the positive results of the year subconsciously influenced my confidence and made me add some risk; and you know the end result. I did not behave correctly.

- *Correct Decision*: Holding MGPI was a correct decision. We all dream of finding multi-baggers, but very few have the strength to hold them for long periods of time. Holding a company for an extended period means you need to endure periods of bad news, corrections, prices that look stretched, news of analysts changing estimates, news of other investors who are selling—all sorts of things happen. But once you sell, you are out. Your body begs for action; you hear that "sell now" voice in your head all the time. Holding MGPI the way I have has made our partnership enjoy some good returns. I believe I have behaved well here.

These thoughts have also led me to evaluate how I describe the time horizon for my investments, as I have come to realize that being a "long-term" investor is just a platitude. I aim to own businesses forever; however, my time horizon depends on management execution.

If I realize that I have been wrong, I need to sell irrespective of whether it is one day after I enter the position. And if management executes well, I would probably hold forever. If facts change my investment thesis, then I should sell or buy more (if the facts strengthen the thesis), meaning *the whole process becomes about estimating which facts are strong enough to change my thesis and ignore all the rest*.

I noted that out of all skills necessary to be a good investor, behaviour, character and temperament are the most important factors, and without an investment committee and no one to blame but myself, I should take advantage of that.

I am not an expert in Excel, and I think any financial analyst could easily beat me on modelling. I also stopped using the toys that I had when working in banking—including *Bloomberg* and *Reuters* (what a great decision, by the way). What I do utilize is the opportunity to control my own behaviour, which ultimately is my competitive advantage.

In order to control my behaviour, though, I have to first understand what is driving it. Imagine a machine that produces the best pencils. If at a certain point in time the machine does not have the correct inputs (e.g., electricity, oil), the pencils produced will be defective, no matter how well the machine operates under normal circumstances. Well, our brains are full of inputs and chemicals that have helped us survive for thousands of years, so I need to ensure that when I make financial decisions, my brain has the correct inputs and that I am not dominated by my hormones and neurotransmitters so that I avoid making defective "pencils." Let me elaborate on what I have done to get better at this.

I have been a voracious reader in psychology in general, but I felt that it was not enough. In 2017, my girlfriend gave me a book called *The Hour Between Dog and Wolf* and that fundamentally changed the way I think about human behaviour. It is a book about an ex-trader turned neuroscientist. The author John Coates explains what happens in the brain when we are exposed to risk, opportunities and danger. I could see that all our behaviours are a result of our human biology and that we need to accept that. Reading that book led me to spend one hour per day learning about human biology, neuroscience and similar subjects. I became fascinated by the topics.

I learned that the basic operation of the brain is the organization of movement—if we do not need to move, we do not need a brain. The brain creates reality even though it has never been exposed to it—it is inside a skull. This is insightful, as we assume that what we know is what is out there; we assume this is real, but it is not. Everything out there is a projection of our brains to help us cope with our environment, so we should not be too convinced of what we know or of our ideas.

One of the main functions of the brain is prediction. In other words, it has evolved to help our bodies predict our future movements to increase the chance of mating, finding food or to avoid being killed by an enemy. Each prediction implies an actual movement of our bodies; the brain receives inputs from our bodies through electrical signals and also through hormones to ensure the brain directs the body towards an action. All of this happens without us noticing. As David Eagleman puts it, “the brain does it incognito.”

The brain learned to find cues from the environment to provide better predictions by detecting patterns, so the brain is wired to find patterns all the time. With respect to actual movements, like in the jungle or the savannah, it worked very well; we are still alive. The problem arises with the exaggeration of this behaviour and in finding patterns in things that have random movements, where the brain has not had thousands of years to learn them. We have very good gut feelings when we feel danger in a dark street—the brain is hardwired to know that darkness is dangerous—or when we suddenly like someone (the brain knows that smiles and diluted pupils are harmless), and the patterns work most of the time. However, the brain does not have great training in finding patterns in all of our activities we now spend our time on. As a result, I am now very careful every time I find patterns, knowing this is my nature and I need to be aware of the tendency. The extreme scenario of finding patterns everywhere is called apophenia and is seen in practices like technical analysis (which I practiced as a teenager) or astrology (which I have not practiced).

Our brains are also not a single entity, but a team. It is a team of rivals, to be precise. There are areas of the brain which deal with instant gratification (if you do not eat soon, you die) and some others deal with long-term decision making. They are physically located in different areas, and this conflict makes us struggle with decisions. Once you notice the conflict, you have just become conscious, but your brain has been working incognito for minutes, days or even years (we are, most of the time, in autopilot). What is fascinating is the fact that once you make a decision, all parts of your brain work together to rationalize that decision. That is why we are so good at explaining things. Now I am doubtful of my own rationalizations and know that rationalizing is automatic. Whether my action was good or bad, my brain will always try hard to say it was a good decision. I need to outsmart this tendency; being aware of it is important.

Before I conclude this topic, I cannot forget to talk about some hormones and neurotransmitters and their effects on our behaviour. From *The Hour Between Dog and Wolf*:

- Testosterone (Hormone): “Testosterone fuels the ‘winner effect.’ It affects the brain, increasing confidence and appetite for risk, but after an extended winning streak, testosterone also causes overconfidence, unreasonable exuberance, and obliviousness to danger.”
- Cortisol (Hormone): “Cortisol takes over if there is in fact a predator chasing you. It is a long-term and metabolically expensive function. Initially, cortisol sharpens your attention and increases your arousal, but over time, it makes you feel anxious, forces you to recall disturbing memories, and gives you a tendency to find danger where there is none. This chronic stress fosters irrational risk-aversion.”
- Dopamine (Neuromodulator): “Dopamine targets brain regions controlling reward and movement. When we receive a valuable piece of information, dopamine is released, providing us with a rewarding, even euphoric, experience.”

Our brains seem to value dopamine more than food. If you ever wondered why we always seem to be in need of information, it is because dopamine is released every time we learn something, irrespective of whether it is true or false.

The medical world says that humans do not have free will, but free won't. This is important, as our bodies ensure they give enough signals to our brains to command certain behaviour/action. When conscious, you can only accept and move (make a decision) or stop. If you think about it, we are not really free—what we have is a VETO power.

All of this is fundamentally important for me as an investor. With financial losses, the body interprets them as harm to the body, so any financial loss will trigger some cortisol to ensure we stop doing whatever is generating that harm (the voice you hear saying "sell now"). After a financial gain, my brain and body will release a lot of dopamine and testosterone (the voice saying "take more risks"), which also makes you believe that the outcome is reliant solely on you, ignoring luck. This cocktail will kidnap my consciousness if I do not have tricks to ensure that I only make decisions at certain times. It makes me realize that a lot of financial decisions taken by investors come from our own mental states rather than the facts of the assets we own. I am now conscious that I have a brain that works together with a body, and the brain, if needed, will try to pursue some kind of action. Hence, sitting still becomes one of the most complicated things, as I need to challenge my human nature.

In a fabulous presentation, Morgan Housel puts it this way: "Investing is not necessarily about what you know; it's about how you behave. And behaviour is hard to teach. It's not analytical; you can't sum it up very well, it's hard to measure."

As I showed above, behaviour is a function of our own biology. I have made behaviour my competitive advantage as an investor, and as you can see, I am working hard to ensure I behave in the best possible ways. I will not stop my human nature, but I am going to accept it and ensure it will not harm me as an investor. The whole point is to develop heuristics to trick it. John Coates concludes it this way, and I cannot phrase it any better: "Written on the Temple of Delphi was the maxim, *Know Thyself*!, and today, that increasingly means know your biochemistry. Doing so turns out not to be a dehumanising experience at all. It is a liberating one."

Part 2

What land, plants and whiskey have in common – The future is always bright, until proven otherwise – We all love sirens

Let's now focus on what happened in 2017. In last year's letter, I explained in detail my experience with Avianca, so I am not going to repeat that now, but Avianca and a company called Gemini (more on Gemini later) were the mistakes of the year and were detrimental to our results in 2017. On the other hand, MGP Ingredients and our new additions like Texas Pacific Land Trust and Calloway Nurseries were the main positive contributors in 2017. Let me explain our main holdings (in no particular order):

Texas Pacific Land Trust (TPL):

We own shares which represent certificates of property interest in a declaration of trust dated February 1, 1888. This trust owns surface state on 887,698.20 acres of land in Western Texas as of December 31, 2017. The trust owns perpetual royalties of oil and gas on approximately 450 thousand acres.

TPL is the result of the failed Texas & Pacific Railway project in the 1870's. The project failed, and Texas & Railroad bonds were converted into shares of the land trust. The trust's mandate was to repurchase shares with cash flows coming from the sale of land. If TPL sells, e.g., $100 of assets, and retires $102 of equity capital, then the remaining certificate holders will have an increased participation of the assets, and compounding will work. TPL did that for a long time.

Oil was found in TPL's land during the 1970's and TPL benefited from the perpetual royalties. This was one of the first times the trust did not have to sell land to generate cash flows. As technology to extract oil and gas was not too advanced in the 70's, the oil was considered depleted and cash flows from royalties diminished considerably. This effect was not an impediment to TPL share certificates compounding at an impressive rate.

To illustrate this, there is Certificate No 390, which was missing for approximately 72 years. It was found in 1979 in the Archives of the Wells Fargo Bank. The certificate was originally valued at $350 when it was lost in 1907. It was worth $5.7 million when it was found, an extraordinary 15% CAGR.

TPL is boring. There is no M&A or spin-offs, but they own land in the Permian Basin, which holds enormous reserves of gas and oil. With the advancement of technologies, the reserve estimates of the basin have increased, given that the oil that was assumed not possible to extract is easily extractable today. TPL does not need to sell land to generate cash any longer.

TPL makes money on the royalties of oil and gas through easement and sundry income, including the right it gives to oil companies to build pipelines in its lands, by grazing leases and, recently, through the new established Water Company called Texas Pacific Water Resources (TPWR). Let me give you an idea of the activity on TPL's lands:

Oil (excluding gas) production in its lands in 2017 was 818,854 barrels, compared to 569,585 barrels in 2016 (44% growth), 384 thousand in 2015, and an average of 150 thousand from 2006 to 2012. Chevron, which is currently the biggest customer of oil and gas royalties, has stated that it will increase production in the Permian by around 30% per year. You can read the annual reports from other oil majors operating in the Permian and they mention similar growth estimates. Important to note is that Anadarko has become the biggest customer of TPL as of 2017, given the additional water services offered to them.

TPL's royalties have an approximate weighted average value of 5%, which is considerably lower than the standard paid in the Permian; this is a powerful incentive for producers to keep increasing production on TPL's lands.

TPRW was established in June 2017, and as per the annual report: "TPWR focuses on providing a full-service water offering to operators in the Permian Basin, these services include brackish water sourcing, produced-water gathering/treatment/recycling, infrastructure development/construction, disposal, water tracking, analytics and well testing services."

Water sales and royalty revenue generated $25.5 million in revenues in 2017, compared to $8 million in 2016 (before TPRW was constituted) and close to nothing in 2015. This means that in no time, water sales generated almost 20% of all TPL's revenue in a year, during which land and resource management revenue **doubled**. TPL is the full owner of any water that is produced on its lands, and do not forget that for every barrel of oil produced, 60 barrels of water (brackish water, not suitable for farming or drinking) are required.

To conclude, TPL is a company that generated $132 million in revenue from $60 million one year earlier (100% growth with no land sales) and continues to grow at high rates (although the exact rates are hard to estimate), where all proceeds except for a small dividend (so far) go to the repurchasing of share certificates. Currently, TPL buys around 1.5-3% of its share certificates per year. TPL's biggest expense is taxes, which have been hugely reduced, and a major source of revenue is about to be tapped into. Sincerely, I cannot think of anything similar to TPL today in the market.

The opportunity exists because TPL is not covered by any analyst; the vast majority of write-ups show it as a short; and because our human biology is more interested in complex and intellectually stimulating situations. TPL is one of the most boring assets out there—who has fun owning just land? Another obstacle to investors feeling comfortable with TPL is the near impossibility to assign a value and anchor to it. TPL is an example of how optionality plays a major role. If I was to valuate TPL in the past, I would have assigned zero to the water business. I would not even have been aware of it. Also, the vast discoveries on the Permian, e.g., the Wolfcamp discovery (estimated in the 20 billion of barrels) which touches the Midland basin in TPL's lands, have been game changers, and they were almost impossible to predict.

In last year's letter, I explained that I was looking for convex situations. Those are situations where, when facts appear and they are positive have a higher effect than when they are negative; TPL perfectly ticks this attribute.

TPL trades at a high multiple oscillating between 40 to 60 P/E. Such multiples can appear too high for anyone looking at quantitative metrics alone and especially for a company that only has land. In order to own TPL, I have to be comfortable with the big picture and not drown in details. I can understand that the water business has huge potential and is only getting started. Major oil operators are constantly increasing production in TPL's lands and TPL's lands have had major oil discoveries, while the major expense (taxes) has been considerably reduced, and all of this is happening while our participation in TPL increases day by day (by the constant repurchasing of certificates). If production continues to grow at similar rates, 2018 can see an additional growth of 40% in production. Last year's average price of oil paid to TPL was $47; currently, oil trades at $65. The additional production means additional easement income, and if water grows at rates of 40 percent, I estimate TPL's earning per share conservatively could be around $15 for this year (assuming 1.5% of certificates are bought back). If this estimate of earnings is somehow accurate, we would have paid less than 19 times 2018's earnings for this marvellous compounding machine.

TPL was a major positive contributor to our returns in 2017, and I expect it to continue to be (not linearly, of course).

MGP Ingredients (MGPI):

2017 was another year of extraordinary results for MGPI. Seeing the radical transformation of MGPI over the last few years makes me proud of the people driving this change. MGP's CEO Gus Griffin has showed incredible leadership skills. He has over-delivered on every goal he has set for MGPI, all while focusing on the long term. This is a very rare skill in managers; since day one, he has sacrificed short-term results for sustainable long-term ones.

In 2017, MGPI increased net sales 9.7%, driven by an 18.4% increase in sales of premium alcohol. Brown goods sales (Whiskey) increased 25%. Gross profit increased 16.4% and EPS increased 34% (EPS growth includes a positive one off), all of this while investing in sales and marketing and considerably expanding its whiskey inventory by 29% to $65.7 million in 2017.

MGPI has managed to invest in marketing and sales to promote its brand initiative, while at the same time increasing its profitability—not many companies can do that. As of today, MGPI has a portfolio of brands including: George Remus, Till American Wheat Vodka, Tanner's Creek and the limited edition of Remus Repeal. MGPI goes step by step; Griffin wants to ensure that the distribution of MGP's brands is done right rather than fast.

When you are developing brands, you need to ensure you partner with the right distributors, the ones who will put your product in the right places; e.g., the appropriate bar/store where your target audience attends. You also want to make sure you learn from mistakes so that when something is done incorrectly you can quickly fix it and improve it. This is the approach taken by MGP, which implies that MGP is not interested in signing national agreements with distributors but in going state by state when the results in the existing states indicate it can continue to expand. I cannot agree more with this approach. MGP's brands are currently in 12 states, so, while slow and prudent, MGP's reach is expanding.

In 2017, MGPI sold its 30 percent ownership in Illinois Corn Processing (ICP), signalling that its focus really is on its distillery products and ingredients solutions business segment (which grew in sales and also expanded margins). The ownership of ICP was a legacy from the previous management team and clearly was a distraction. MGPI paid a handsome dividend to shareholders as a result of this transaction. Another corporate action to keep in mind was the new credit agreement providing for a $150 million revolving credit facility. While this agreement is not currently needed, it can serve as a free option in case MGPI finds a brand it can acquire. If that opportunity presents itself, MGP needs to be ready, and it is.

MGPI is already a four-bagger for our partnership. To refresh your mind, I put 30% (at cost) of our money in it in late 2015. Given the meteoric rise in price, I have trimmed a few times, which I am aware can be a costly mistake. In total, I have trimmed around 37% of the shares I initially bought—the proceeds of those sales and the dividends received are substantially more than the entire value at cost when I initiated the position in MGPI. I am not saying this is smart; this can actually be very dumb, as I have reduced our participation in a wonderful company that has had an extraordinary execution (selling the winners for buying something else is not good). I just simply do not want to have extremely outsized concentrations.

With that being said, MGPI continues to be our largest holding, and I could not be more satisfied with the execution of its management team. If you have followed MGPI over the last few years, I'm sure you will agree that it is an amazing story.

Calloway's Nurseries (CLWY)

Last year, I spent three weeks in Dallas. There, I learned about a Microcap called Calloway's Nurseries. CLWY is located in Dallas, so I could engage in some scuttlebutt.

CLWY is a 20-store chain of high-margin plant and garden related stores in Dallas Ft and Houston. CLWY owns 11 properties out of the 20 stores. In December 2014, the company sold a store in Houston with a financial gain of $10 million—this number comes by studying CLWY statements as there are no disclosures about this transaction. I do not need to be a genius to know that the value of the real state is higher than the current market cap of the entire company, which at the time of writing is around $57 million.

The controlling shareholder is 3K. 3K is a family office run by Peter Karmin who was a co-founder of Value Act capital. If you are familiar with 3K's approach, they follow an interesting pattern—slowly build a position, take control, repay debt, meaningfully decrease expenses, sometimes down-list companies, and eventually make them private. 3K has now taken full control and has placed a new management team. With only one year of 3K running the show, earnings per share increased from $0.26 to $0.69, and the stock currently trades around $7.0. This result is truly impressive, and CLWY remains very cheap.

On the April 6, 2018, the 20th store was opened, so on top of the increased operational efficiency, CLWY will continue to have healthy growth. This combined with a quality portfolio of properties and a top class controlling shareholder makes me think this is a truly amazing opportunity.

CLWY does not file 10K's, they are required only to disclose the following items each quarter: Three pages including the Income Statement, Balance Sheet and Cash Flow Statement, nothing else. This lack of disclosure scares 99% of the investment community. In early 2018, CLWY paid a dividend that was more than 10% of the money I invested at cost. I truly look forward to CLWY's progress and I am happy to invest alongside 3K.

Franklin Covey (FC)

I ended last year's letter by saying that I had initiated a position in a company that offers consulting services to corporations and was transitioning to a SaaS business model—this company is Franklin Covey.

Companies with a successful SaaS business model and low churn operate at high multiples given the desirability of business with high recurring revenues. However, for FC, the transition meant harming financials for a long period of time. To illustrate the change in accounting, please consider that a transaction in the original business model implied that FC recognized 100% of the sale as revenues at the inception of the sale; in contrast, a SaaS business model recognizes the revenues in the income statement over a period of time (in the case of FC, this period is 12 months), while expenses to generate those revenues are immediately recognized on the income statement.

New business model example: FC sells a contract of its All Access Pass for $20 thousand; contracts are only for one year, so the journal entry at inception is as follows (only on the balance sheet):

Cash $20 thousand (Assets) Debit / Deferred Revenue $20 thousand (Liabilities) Credit

As time passes, the following takes place:

Deferred revenue $20 thousand (Balance Sheet - Liabilities) Debit / Revenues $20 thousand (Income Statement) Credit

Over the 12-month period, the deferred revenue on the balance sheet will move to the income statement—that is it. It sounds simple, but this shows lower sales for an extended period of time even if the model is extremely successful. As all new sales go to the balance sheet year over year, comparisons will be meaningless for a while.

I waited until I had data for the first renewal rate; this meant that I had to wait one year until the first renewal was going to take place. The renewal rate was north of 90%, which was the ultimate trigger I needed.

FC has had to face a lot of scepticism during its transition. As of the time of writing, FC has had already two quarters past the inflection point, as stated by the CEO: "***We are now at an inflection point where this large balance of deferred revenue will reverse and be recognized as revenue, driving strong reported and economic growth in fiscal 2018 and beyond*.**"

To illustrate FC is past the inflection point, its results on Q2 FY18 showed:

+20.5% revenue growth, +59% Subscription revenue growth, +138% of subscription related revenue in enterprise division (All Access Pass) and +23% in deferred revenue growth, 70% record gross margins, and +44% increase in paid subscribers. We can say we are past the muddy financials and the transition is working.

FC also is selling multi-year contracts; those are not shown in the financials but show the stickiness of its clients. FC will continue improving margins as more deferred revenues without expenses associated with them (as they were recognized before) will land on the income statement. Revenue is estimated to grow 14% in 2018. Let's say a very conservative 10% growth in calendar year 2019, resulting in $233 million in sales, at a 13% EBITDA margin; this would mean around $26 million of EBITDA for 2019. My estimate of calendar year 2020 is $40 million of EBITDA, while FC still has an Enterprise Value of $390 million. A price I consider too low for a successful SaaS company, with healthy growth in subscribers, expanding and positive EBITDA and a high renewal rate. FC is also a full beneficiary of the tax reform.

To finalize, early in January 2018 and post the inflection point, the financials started to show the improved numbers and the stock appreciated substantially and has been trading around $25-30 since then. While the gap between value and price started to shrink, its value will continue to increase as long as management continues executing, and I am happy holding as long as that is the case.

Additional Activity

- I sold the full position of Precision Drilling (PDS) at an eight percent loss. Drillers did not benefit from the increased price of oil. New contracts reflected a much lower pricing and Precision and other drillers struggled to generate cash. Clients took advantage of the depressed spot prices and signed long-term contracts, hurting future profitability for PDS. As I saw this dynamic, I felt uneasy having our capital exposed to drillers. In addition, Precision had some debt I was not comfortable with. Our losses were minimal compared to what the stock price did next; the timing was pure luck.

- Early in 2017 I initiated a position in a company called Rightside. Rightside used to be a registrar and registry of domain names, the domain being the ending of a website like the ".com". The registry owns the names and the registrar (such as GoDaddy) distributes them for a fee. Rightside was acquired by a company called Donuts for a price I considered too low. Unfortunately, we did not have any alternative but to sell. We had a +25% return while we held Rightside.

- I bought a trust called Mesabi Trust (MSB) in 2017, the rationale being very simple: MSB owns land that produces iron ore which is sold to Cleveland Cliffs. In 2017, a new contract was signed with Cleveland including a new formula that substantially increased the price paid to MSB. It was a simple set up when I found the opportunity as EPS was supposed to increase from $0.73 to an estimate of $2.4 to $2.8. The actual 2017 EPS number was $2.50. I sold the trust in 2018 for a 50% gain as a result of the uncertainty brought by the tariffs imposed by the US government. I understand if you think that tariffs should benefit the price of the US iron. Well, in the investing world, the macro calls that are obvious sometimes are not really so; I decided to take profits and allocate the proceeds to other ideas.

- I also sold 100% of the position in Bancolombia. The stock kept appreciating while the non-performing loans kept climbing and results deteriorated. The risk reward was not enough as valuation and price changed, it simply made no sense for me to keep the position, and after all, it is a bank, which by nature is fragile and vulnerable to sneezes in the economy and other things. We generated a 30% return on the investment, not something I am proud of as we kept the position for more than two years.

- I sold our participation in Spirit Airlines (SAVE). Spirit has failed the test: For every dollar of retained earnings, we have less than one dollar of value. Spirit Airlines is a good company, with one of the best margins in the industry, a good management team, and operates a segment with a huge potential (Ultra Low Cost). Unfortunately, the consolidation in the US resulted in airlines needing to constantly operate under a "Game Theory" scenario. If participants are rational, decisions should benefit the whole industry. Despite the fact that the majority of participants seem to be kind of OK, United Airlines has consistently increased capacity in a lunatic manner. If a small company operates in a United Hub, United will defend that hub at all costs, reducing prices of several flights that have to be matched by any airline that offers that route, and hence generating a very dangerous snowball effect.

United's increased capacity was the trigger last year for the huge drop in airline fares. Not having learned by the result of its decisions (all airlines made less money), during the investor presentation in 2018, United announced that having more connections was essential. It did not mention how profitability could be achieved and forgot to remind shareholders that all of its objectives set in the previous year's management presentation were not achieved. United's management team has a hammer (increase capacity) and everything is a nail. They are oblivious to something called common sense and their egos play a major role, I believe, due to lack of skin in the game.

If you want an example to understand how incompetent United Management is, just look at the idea they had early in 2018, when they decided to stop all performance bonuses to employees and instead the bonuses would be assigned by a lottery to a few winners. Management bonuses (un)surprisingly were not part of this agreement—you go figure why. Of course, they had to cancel that initiative after a huge protest by employees, I guess by the ones who work harder. Imagine a company where your performance does not matter—well, that is how management at United thinks.

Therefore I do not want to have our capital in this industry. I think Spirit will do well in the long term but honestly, I currently have much better ideas; at least, I believe so. We sold the position at almost the exact same price I bought a few years back, so essentially the investment has been dead money and has been a mistake.

- Our project on Asymmetric-Convex situations where we deploy a very small amount of capital has started to deliver some returns. Last year I bought some out of the money calls on FIAT, the stock doubled and the value of our options increased six fold. We also hold small positions in biotech companies. All positions in this segment are very small as my expertise on the companies and industries is limited; I am just trying to be exposed to very asymmetric situations.

Big Mistakes

The following only applies to Partnership 1. In 2017, I bought a company called Gemini Corporation (GKX.V) and sold it at a 50% loss. 100 percent of this mistake is my responsibility; let me explain what I learned by this experience.

Gemini's services mostly consist of building and maintaining energy and industrial facilities. The company's principal target markets are oil and gas, heavy oil, oil sands, midstream and pipeline facilities, hydrocarbon processing, power and other industrials.

The company services its clients by delivering projects throughout the full life cycle of their assets. In

2014, the company signed the largest contract in its history—a rail-loading facility. The company did not have the experience for such a large project and it ended up having overruns which generated huge losses. As a result of this, management was replaced in 2016. The new management team came and immediately bought shares in the open market and continued doing so for a couple of months.

I saw 2016's financials that showed a balance sheet with no debt. The company was trading at two times EBITDA and one-time cash flow (including working capital) and the new management team, which I had the opportunity to speak to, seemed honest and clearly had some skin in the game. Management was very enthusiastic on the contracts the company was perusing and had guidance saying that revenues in 2017 were going to be higher than 2016.

With that in mind, I decided to buy, and it was not the smallest position. What happened next was disastrous. In 2017, Q1 proved that almost all—yes, all—contracts that Gemini was trying to win were lost to the competition. The company had to borrow some money and of course guidance was changed. These, friends, are real facts. I cannot keep a company on the hope that better things will/might happen, so I put it in the red zone. The red zone is a situation on a company when facts change my thesis and I need to decide whether to sell or hold.

When I have negative facts that are threatening to my original thesis coming from a company I own, I never buy more shares. That is the ultimate gamble-ruin game—play it and you are guaranteed to lose it all, which is not the same as when prices drop in the **absence** of relevant facts. We need to survive, most importantly. Faced with those facts, I decided to wait to see if the company managed to secure more contracts. Q2 and Q3 results came and were even worse. The company managed to secure only a few minor contracts, as clients were taking advantage of the low prices and signing 2018 projects (like PDS). Additionally, the CEO, who had been there for a short period of time, left the company. Now my entire original thesis was proven dead wrong. If I had continued holding, it would have been due to some ego or stubborn internal mental state, and the final facts were devastating. I sold all the position and we lost money.

I cannot explain what I felt when I discovered Gemini. I really thought it was a great opportunity and was already dreaming about press releases announcing new contracts and good news. The dopamine that my brain released, I think, was so much that it made me unconsciously decide to enter the position the first time I learned about the company. I really think my entire future due diligence was under the dopamine effect and my brain had already decided without me being aware. I learned how huge delusions on "future potentials" can drive my body to produce hormones and/or neurotransmitters that will influence my decision-making process. My future studies on biology, in learning what we know today on how the brain works, are with the objective to trick the effects of the chemicals in the brain and not let them win me over, as in this case.

I failed to estimate the risk of the cash flows; I thought they had a high probability to happen. There are not certainties on cash flows, especially in an industry that needs to bid for projects. This is truly an unforced error—I should have known better.

I assumed the management's skin in the game was enough, as they knew what was going on. This last point was a huge lesson as management buying in the open market was one of the best indications I had. For me, this was a powerful message. I learned that they are humans too and can feel overconfident. We think that if something is done by us, then it has to work because it is done by us! Management can feel the same way and acquire shares in the open market as a projection of their confidence rather than as a message indicating the actual state of the company. I learned to be more cautious with assuming that management buying is exclusively a good thing.

I think the Gemini example taught me a lot, not only about myself but about how humans act. I will make more mistakes—many. I will try not to make the same ones I made here, this is my promise to you.

Outlook:

- I am buying shares of a company growing organically at 40 to 50 percent, with no debt, and it is only scratching the surface of its total addressable market. The company was recently spun off, it operates in the healthcare industry and it is trading at 5 times EBITDA and its inside ownership is 11%. This is a high conviction idea.

- I bought a small company that focuses on exploration, development and production of natural gas in Turkey. It seems they have made an extraordinary discovery that the market has yet to price.

- I bought another company in the healthcare industry. The company's revenues come from federal payors (30%) and commercial payors (70%). The federal payors incurred a price cut that sent the stock more than 80% lower, to a level that reached seven times free cash flow after factoring the effect of the cut. The company's free cash flow is growing substantially, mostly inorganically, and the company is engaged in an aggressive buyback program.

- I started a position in 2017 and keep buying shares of a UK microcap company. It is a fast-growing developer and manufacturer of sheep monoclonal antibodies under a royalty business model. Run by an owner-operator, it has grown EPS around CARG 40% in the last few years and it has a new segment that can drive further growth.

After the Trojan War, Ulysses was travelling back to Ithaca, his island. On that voyage, Ulysses had to pass the island of Sirenum Scopoli, where the gorgeous sirens sang melodies that made all sailors mad and sail towards them. Sailors were so enchanted by the melodies and the sirens' beauty that they were oblivious to the rocks, dashing into them and drowning all on board. Ulysses was desperate to hear the sirens sing, but not make the same mistake his predecessors had made. So he made his sailors fill their ears with beeswax and had himself tied to the mast so he could hear the sirens sing. He also ordered them to ignore anything he would say until they had passed the sirens' island, no matter how much he yelled. Ulysses knew in advance that he was going to try to order his sailors to go to the island. He was protecting himself and his sailors from his future self; a Ulysses dominated by a stimulus that would block all his rationality. This is called a Ulysses contract—a contract to protect us from our future selves.

All the studies I have done in human biology has been with the purpose of understanding a little about how the human brain works and to create Ulysses contracts with myself that fit my personality. I am aware of how easily different stimuli can trick my brain; the key is to establish Ulysses contracts before I hear the sirens' songs. I already have several Ulysses contracts with myself.

As always, I cannot promise returns, but a philosophy. I cannot promise I will be right, but I can promise a behaviour that will ensure I rub my nose in my mistakes when I am wrong and luck will always play a role in our results. I have made behaviour my competitive advantage. I see our holdings as real companies, not as tickers on a screen. The market is only a place I visit every now and then, and I am not interested much in what happens there compared to what happens inside our companies.

I am very glad to share that last year I was able to attend the course taught by Nassim Nicholas Taleb (my hero) in New York. This course has been one of the best things I have ever done. I will continue seeking wisdom from great thinkers on all disciplines; as you have noticed, human biology has kept me busy for some months.

Having a clear process and correct behaviour is how I expect to protect our capital from whatever the future has in store. I hope you are as satisfied as I am with the results of our first four years. Please feel free to reach out anytime.

> *"One day you'll leave this world behind*
> *So live a life you will remember"* - Avicii

> *"Nothing without skin in the game"* - N.N. Taleb

Thank you for your trust,

Best Regards,

Jean Philippe Tissot

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