



October 13, 2019

Dear Fellow Investors,

The Fund appreciated less than 1% during the third quarter, bringing YTD returns to approximately +13%. Please check your statements as returns will vary slightly by share class, etc. The Russell 2000, which represents market cap companies more likely to be found in our portfolio, declined -2.4% and the S&P 500, which represents larger market cap companies gained +1.7%. Ultimately, I want to be judged on our long-term absolute returns, not relative returns on a short-term basis. One of the benefits of only reporting quarterly is that I do not have to attempt to explain the daily gyrations of the equity markets, which have only been exacerbated in recent periods by the Twitter account of a certain elected official. This is just a mark – a moment in time. Like the markets, the Fund did experience some volatility during the quarter, and we will continue to have up and down quarters and years. Fortunately, I believe our portfolio is spring-loaded with several holdings that have the potential to appreciate meaningfully over time.

THINKING IN BETS (HOMAGE TO ANNIE DUKE)

I come from a family of high achievers, but only one can be the smartest, and Uncle Al, who earned a Ph.D. in nuclear physics, was the smartest of the smart while he was with us. Unfortunately, his love of gambling and his distaste for conventional work led to a life of borrowing from family members. Gambling is frowned upon in the Miller family. To be clear, I don't think of my investing as sitting around and gambling my life savings, and a portion of yours, when I make decisions for Greenhaven Road. However, when thinking about how our portfolio is constructed, treating each holding as a discrete "bet" is helpful. The reality is that each holding has a logic, range of expected outcomes, and expected payoff.

In these letters, I describe our 5 largest positions and write in detail about significant new positions. These bottoms-up descriptions are meant to update everybody on what we own and why we own it. How these holdings relate to each other in the overall mosaic has been less discussed. In this letter, however, I will touch on how our investments can be both similar and fundamentally different from each other, clarifying the logic of our portfolio.

Each investment should stand on its own, but when put together, our entire portfolio should not be different versions of a bet on interest rates or different versions of a bet on a strong economy. In addition, unlike Uncle Al, I am trying to steer very far away from bets with negative expected values, such as horse racing, where your entire bet is lost on a loser and the house takes 17% off the top on a winner. We are not trying to pick up nickels in front of steamrollers. Our bets should offer substantial upside with minimal exposure to a permanent loss of capital.

Greenhaven's holdings typically can be divided into what I consider high-quality companies and special situations, the latter of which tend to have shorter holding periods and should be less correlated to the overall market. The mix between the two will vary depending on what is available in the marketplace. High-quality companies, to me, are typically asset-light businesses that require no additional capital and have long runways for growth and high insider ownership. Over time, I have found that these are often software companies or asset managers. Within these companies, there are at least two types of bets: the maintenance of status quo (which includes continuation of trends), and going from good to great.



For example, our investment in KKR (KKR) is a bet on status quo/trend continuation. Assets flowing to private equity have risen an average of +12% per year for over the past decade, and KKR's assets under management have risen even faster. If there are no changes in industry dynamics, we can easily double our money just by sitting still and enjoying the tailwind. If there is a change, it will take years to play out and, given the strength of the balance sheet, the likelihood of large sustained losses is minimal.

Our "bet" on Etsy (ETSY) is also one on status quo/trend continuation. The thesis is that Etsy will remain a viable niche alternative to Amazon and will continue to improve the monetization of their two-sided marketplace. Our bet on Digital Turbine (APPS) is that they will continue growing their distribution channel for apps on smart phones, particularly for slots controlled by carriers. If successful, we will see the number of devices and revenue per device continue to improve. KKR, Etsy, and Digital Turbine are all asset-light businesses where additional growth will not require raising additional capital, and they should benefit from operating leverage such that their margins should improve as their revenues grow. Thus, even in a "status quo" scenario, the underlying economics should improve and there is not a reliance on the capital markets to get there. They are in control of their own destinies.

It is worth highlighting that while KKR, Etsy, and Digital Turbine are all "bets" on the status quo, they are different in that KKR's end market is institutional investors, Etsy deals with small merchants and consumers, and Digital Turbine deals with cell phone carriers and large companies with apps. These different end markets also all have different dynamics and are largely independent.

Historically, Nintendo (NTDOY) has not been a high-quality business as almost all of its revenue was tied to the booms and busts of the video game console business. Unlike our "status quo" bets, our bet here is that Nintendo is *becoming* a high-quality business. The transformation is being driven by Nintendo's transition to the Switch gaming platform, which should have a significantly longer life than the traditional video game consoles. Nintendo is also layering on significant subscription revenue and better monetization of IP in mobile games. These changes should provide more recurring revenues with higher margins. If this transition continues to progress, Nintendo will have revenue growth, margin improvement, and multiple expansion.

Often sitting in the gray area of high-quality companies and special situations are our most common bets: "jockey" bets. Given my operating experience, I am a firm believer that people build businesses. Particularly in the context of a smaller enterprise, the contributions of a "jockey" can be profound. These are not super humans who can overcome all challenges, but the right jockey pursuing the right strategy with a little bit of good fortune can be very profitable.

One of the positive attributes of jockey bets is that their outcomes should be almost entirely independent from each other. While not immune to the overall economy, it is the company-specific micro, not the macro, that drives these bets. As an added bonus, these companies usually have very high insider ownership.

We currently hold four jockey bets:

- 1) Par Technology (PAR) is a wager that Savneet Singh will capitalize on the restaurant POS (point of sale) software opportunity currently buried under a defense business and a hardware business.



- 2) EnviroStar (EVI) is staked on Henry Nahmad’s ability to execute his buy and build strategy using a combination of cash flow, debt, and equity in non-cyclical industries.
- 3) Chicken Soup for the Soul Entertainment (CSSE) is a bet that Bill Rouhana will continue to build through intelligent deal-making. He got Sony, a \$70B Japanese conglomerate, to partner with his \$120M market cap company on their streaming business, Crackle. Sony has invested hundreds of millions of dollars into building Crackle and its associated content. Bill structured a win/win deal where CSSE put no money down and yet was given the keys to Crackle while allowing Sony to benefit if he is successful. As part of the deal, CSSE got part of Sony’s ad sales team. As Bill indicated on the last call,

“As far as the acquisitions go, most of the tuck-in acquisitions we’re looking at, Jon, actually pay for themselves. And the primary reason for that is because we’re buying guys who are getting \$8 or \$9 CPMs.... But if we buy \$8 or \$9 CPM businesses, move them onto our platform, and get \$19, you can see there’s a lot of room for a very profitable arbitrage there, which is immediately cash flow positive and which essentially could pay for itself.”

Insiders own more than 60% of the common stock, there is limited analyst coverage, and it is not in any indices. We will see if Bill can do everything he says he can with this opportunity; either way, this jockey has already negotiated himself from the kiddie ponies to a race horse.

- 4) Our final jockey bet is the Canadian software company Optiva (OPT) (formerly Redknee). ESW Capital has built a playbook for improving the economics and business quality of software companies through standardization and outsourcing, honing their playbook on 40 software acquisitions. So far, the company’s cost structure has been massively improved, the product line-up has been greatly strengthened, and they Optiva just signed their first new customer since the turnaround began. ESW brings a specific set of processes, procedures, and talents to Optiva that make the likelihood of success and the potential payoff far more attractive than a roll of the dice. Time will tell.

Another type of bet in our portfolio is the balance sheet play. Put simply, the assets of the holding should more than cover the average price that we pay for our shares. For example, the land and equipment at Scheid Vineyards (SVIN) cover the current share price by more than 3X – or to put it another way, shares are trading at one-third of replacement cost. I am not a huge fan of the 30-cent dollar and don’t want an entire portfolio of discounted merchandise, but I think there is a different risk profile for balance sheet investments.

We made an entirely different bet this past quarter on a special acquisition company (SPAC) called GigCapital (GIG), discussed in more detail later in the letter. We invested in both the rights and warrants of this company, betting that the deal will close. Our thesis is as simple as that – the deal will close.

We do have one bet that is substantially more cyclical in nature: building product distributor BlueLinx Holdings (BXC). A large part of their business is selling plywood to homebuilders, therefore revenue is undoubtedly tied to new housing starts in the United States. While low interest rates and demographics over the medium term should provide tailwinds to housing starts, the core bet with BXC is that the company will be able to successfully integrate



their acquisition of a competitor, Cedar Creek. The two distribution companies had significant geographic and product overlap, and the potential for margin expansion and efficiencies are significant for the combined business.

If the company reaches close to their projected post-deal cash flow, our shares were purchased with a 30%+ pro forma free cash flow yield. I don't want a portfolio stuffed with cyclical holdings, but in this case, the cyclical aspect is an embedded risk that may prove to be a headwind or a tailwind. It just happens to be a cyclical company. The larger driver of returns will be the integration of the two businesses, which (if successful) could yield multiples of our original investment.

As a long-biased fund, it should be noted that, even though the individual bets are discrete, we are assuming market risk. As equity markets have had positive returns over the decades, this is a risk I am comfortable assuming, but there will be periods where the market selloffs overwhelm incremental progress at the company level.

By grouping and articulating the different types of bets, I hope that what may previously appeared as eclectic portfolio construction will now demonstrate logic and intentionality.

TOP 5 HOLDINGS

KKR & Co. (KKR) – The thesis remains the same, a strong balance sheet with \$17+/share in cash and investments, an undemanding sub-6X distributable earnings valuation (ex cash and investments), conservative accounting, high insider ownership (40%+), and strong secular tailwinds with the industry growing AUM at +12% per year. KKR shares sold off more than 10% on news of Elizabeth Warren's bill targeting private equity. In the short term, her bill will certainly be part of her campaign trail talking points. However, for the bill to actually become a law would seem to require not only that Warren becomes the nominee and beats the incumbent, but also that Democrats also carry the House and Senate. On top of this, it would also require that private equity lobbying groups also prove ineffective at muting the legislation.

The proposal has three major components. The first is eliminating the preferential carried interest tax treatment, which would not impact us as shareholders at all. The second taxes certain "monitoring" fees at 100%, effectively eliminating them. KKR does not break out the materiality of these fees, but given the employees own 40% of the firm and have over \$5B of their own money invested in KKR funds, it seems unlikely that charging themselves fees is the secret sauce at KKR. The final component of the legislation would tie the debt and pension obligations back to the funds. It seems highly unlikely that this feature can be done retroactively or would apply to non-U.S. companies, but going forward it could make the more levered companies less attractive, and it could help employ hundreds of lawyers to find the workarounds. In my opinion, none of these policies should impact the flow of AUM to KKR. Clearly, having Elizabeth Warren on the campaign trail vilifying private equity funds is not ideal here, but her actual proposal is by no means a death blow to KKR. The only thing I know for sure is that nothing will happen before 2021.

Digital Turbine (APPS) – Our Digital Turbine thesis remains exactly the same. Digital Turbine serves as a neutral third party that works with wireless carriers to pre-install apps on new cell phones, then sells the "slots" to app-driven companies such as Uber, Amazon, and Netflix. The company is in the early stages of a relationship with



Samsung, the world's largest cell phone manufacturer, to enable Digital Turbine to monetize in geographies where they do not yet have wireless carrier deals in place. Over time, I expect the number of devices as well as the revenue per device to increase materially. In my view, both of these earnings drivers could go up 50% and the share price can still appreciate significantly. The company guided to revenue growth in excess of 40% and indicated that the base of recurring revenue from their revenue sharing deals continues to grow.

PAR Technology (PAR) – Over the course of the quarter, we significantly increased our investment in PAR as I believe that the actions of management today will pay significant dividends in the future. In the case of PAR, seeking progress from the GAAP financials is a futile effort. The asset we want to own is the restaurant POS (point of sale) system, Brink, that remains buried under a defense contracting business and a hardware business that are currently far bigger.

Here is what we know: the new CEO, Savneet Singh, has only been on the job since the beginning of the year and has only had resources since April when PAR raised money through convertible debt. Hiring well and spending well takes time. Savneet has focused the company and laid the foundation for growth by investing resources in stabilizing the product, building a payments offering, announcing the exit of a small ancillary software business (SureCheck), and articulating that the defense and restaurant businesses should be separated (timing uncertain). He has also taken actions to improve the profitability of the hardware business through both staff reduction and growth, most recently paying less than 2X cashflow for a drive-through related asset that fits well with the existing portfolio of restaurant solutions. This acquisition provides more stability to the hardware business and makes it larger, which makes the hardware business easier to separate. While new installations for Brink software were uninspiring last quarter and are likely to be uninspiring this quarter, these results are consistent with a desire to fix the product and please their customers in the long term. The decision to slow growth and build a more solid foundation is exactly the type of decision I want our jockeys to make: some short-term pain for longer term benefit. Several large chains, including Panda Express, are in pilot with Brink. Coupled with announced wins like Dairy Queen, a path to doubling the installed base of Brink over the next 12-15 months remains intact.

Where is this all headed? Before becoming CEO of PAR, Savneet was trying to buy private software companies and build a “Berkshire of Software.” He ended up putting aside that project and joining PAR. While he was trying to acquire software companies for himself, he wrote an article “Building the Berkshire Hathaway of Software” ([LINK](#)) where he laid out his thinking:

“The software we focus on is the type of mission critical service that acts as the backbone of a business; where there is no benefit to switching and the product delivers far more value than it costs..... The beauty here is that so long as the software continues to get better, customers won't leave, allowing the founder to have 98% of last year's revenue come in on day 1 next year ...before he/she has spent a dollar on sales and marketing... In summary, we are talking about a business that can keep its customers for decades, maintain high margins, can potentially raise prices AND find places to reinvest... That's a Berkshire Business.”

It strikes me that an enterprise-wide POS system is exactly the type of mission-critical business Savneet was referring to.



Because the POS system is central to every transaction in a restaurant, it interfaces with more than a dozen other operational functions a restaurant operator must navigate such as inventory management, staffing, and loyalty tracking. PAR has the opportunity to buy, build, and partner in several of these adjacent functionalities and capture a portion of the economics. This quarter, the company is launching a payments module, which has been a larger source of profits for competitors than their software offerings. The acquisition opportunity would appear robust as well. If PAR can buy a small SAAS offering such as inventory management or labor management, integrate the offering, and then sell into their growing customer base, the combination of organic growth and acquisitions could yield very high growth rates for the next several years.

Putting the pieces together, PAR has a rapidly expanding customer base that can be monetized at significantly higher rates. The sale of the defense business can provide the “war chest.” There are well-funded competitors, the board may have a different vision, and building a business is difficult, but if Savneet is successful, we are not playing for just +15%.

BlueLinx (BXC) – BlueLinx has appreciated itself into being a Top 5 holding, rising over +40% during the course of the quarter. Investors that bid up the stock were clearly not focused on the reported revenue numbers, as sales declined almost -20%. There were a couple of developments that may have led to the rising share price. First, the company got its first analyst coverage, so now there are sellside earnings estimates, which may have attracted some of the quantitative investors. The company has 9M shares, a sub-\$300M market capitalization, and is currently running at approximately \$100M in adjusted EBITDA per year. Now, there is debt, but all of the earnings improvements that would come from revenue growth would accrue to the equity holders (us). Thus, it was a positive development on the earnings call when the CEO said, “*We have challenged our sales teams to grow our revenues from current levels by at least 10% in 2020 and another 10% in 2021.*” This seems like a tall order, and a radical departure from concerns some investors have had about potential lack of synergy from the merger with Cedar Creek. The combined company should benefit from lower interest rates, and there are several paths to \$10+ per year in free cash flow. This is not a great business, but it may turn out to be a very good investment.

SharpSpring (SHSP) - Over the course of the quarter, I was voted onto the board for SharpSpring (SHSP) and attended my first meeting. The rationale for joining the board was discussed in our [Q2 letter](#). As an “insider,” I will refrain from discussing the company in detail in the letters going forward. I can say that I was impressed with the breadth and depth of data that management is using in their decision making. As a member of the Board, there will be strict windows when the fund can buy and sell stock, thus there will be times where we buy or sell just to maintain our position size/portfolio weighting. It may be as simple as money came into or left the fund and I am adjusting accordingly. I do not intend to discuss these purchases or sales, but would encourage observers to not read too much into them positively or negatively.

NEW INVESTMENTS – GIG CAPITAL RIGHTS & A SOUTH AFRICAN HOLDING

The fund made two new investments over the course of the third quarter. The timelier of the two investments is the previously mentioned GigCapital Rights (GIGRT) and GigCapital Warrants (GIGWS). GigCapital is a SPAC (Special Purpose Acquisition Corp) or blank check company. As a group, SPACs have not been a good investment.



An astute observer on Twitter properly renamed them “Murder Holes.” Gig is currently in the process of purchasing an Italian company, Kaleyra. Given the SPAC set-up, Gig shareholders have to approve the transaction. If they do so, the rights turn into shares and have value. If the deal is not approved, the rights are worthless. The date of the vote has not been announced, but should happen in the fourth quarter.

Because of the limited number of rights available (14M) and the potential for the loss of capital if the transaction is not approved, we have limited the at-cost size of this position; however, it does have an excellent return profile. Without giving away all of the details, a confluence of deal-specific items make the likelihood of the deal not going through extremely remote – call it sub-5% – in my estimation, while the expected payoff is more than a double.

To my knowledge, I am the only investor to travel to Milan to meet the company being acquired, and the first investor to negotiate for the sale of the rights on favorable terms in the event that the deal is consummated ([LINK](#)). If the deal closes, we have locked in profit and retain the upside above a share price of \$10.50. None of this guarantees that we will make money on this investment, but I have done everything I can to tilt the outcome in our favor. Again, time will tell.

Second, over the course of the quarter, we continued to purchase shares in a small South African company. Our core “bet” is that the underlying earnings power and forgiving valuation will overcome the macro headwinds that will undoubtedly arise. The company has high insider ownership (40%+) and is a best-in-industry operator in a cyclical industry that I believe is currently closer to the bottom than the top part of its cycle. While their competitors are going out of business, this company is still profitable and generating double-digit returns on equity. A normalization of the cycle would mean 1) increased volumes and 2) margin expansion, which should lead to profit growth. The company trades at a substantial discount to book value, and a Price to Earnings ratio of less than 3. Remember, these should not be peak earnings. As we are not done purchasing shares, I will withhold the name.

The source of the idea has been Rudi van Niekerk of Desert Lion Capital. As you may remember from its [Q2 letter](#), our Partners Fund provided seed capital to Desert Lion. Rudi has proven an invaluable guide in navigating the South African investment landscape and organizing my trip to see the company in the spring. For impatient LPs, there are more clues to the company in Rudi’s last letter (Ally can provide).

“Why bother with South Africa?” is a fair question. For me, there are two parts to the answer. The first is a desire to hold some non-U.S. companies. While it is true that the world catches a cold when the United States sneezes, South Africa is in the interesting position of having not meaningfully participated in the last decade’s equity market growth due to poor political leadership, poor policy choices, and corruption. I believe that new leadership and positive reforms are likely to place South African equity markets in a position to be less correlated to developed equity markets yet produce positive returns, albeit more volatile. This is intended to be rational diversification.

The second and more important reason to venture to South Africa is the potential for returns. With a bit of continued growth, operating leverage, and anything approaching a fair multiple, I believe that the price of the shares we are acquiring could very realistically go up 5X. A hundred things can prevent that type of return from being realized, but given how absolutely beaten down South Africa is from a valuation perspective, any return to normalcy could produce abnormally positive returns.



SHORT POSITIONS

The fund has a very long bias and remains short ETFs targeted at short-term traders. We are also short two ETFs that are proxies for major indices, an auto manufacturer with a credibility problem, and a wildly valued consumer goods company where there appears to be a complete disconnect between the multiple (high) and the growth rate (meh). We are also short an industrial company and a company where we believe the best explanation for the valuation is “ticker confusion.” During the quarter, we also initiated and exited two short positions in the cannabis industry, which is an industry with a lot of built-in optimism and little operating history.

ANNUAL MEETING

Our annual meeting is quickly approaching on October 16th in NYC. I am looking forward to seeing many LPs. In the room we should have all of the important Greenhaven constituencies. In addition to limited partners, we will have a CEO from a portfolio company, several portfolio managers from the Partners Fund, and our seed investors from Stride Capital/Royce. For those of you who cannot attend, a recording will be made available. Please reach out to Ally with any questions (InvestorRelations@greenhavenroad.com).

OUTLOOK

It is worth noting that we have exited our last remaining position in the S&P 500. This means that we are not currently getting some of the tailwinds from the largest companies where the stocks have performed exceptionally well, or some of the “growthiest” companies where the multiples have expanded the most. The biggest risk I see to equity markets is multiple compression, particularly those based on a multiple of sales. A company trading at 10X, 15X, or 20X+ revenue has a lot of optimism built into the price. This is not to say that we won’t “bet” on growth; we do own PAR and Etsy, and I love platform businesses. Before the sun sets on Greenhaven Road, we will likely own some combination of Google, Facebook, and/or Square. However, in this environment, I am more comfortable to nibble around the edges of capitalism.

Just as I ended the last letter, as volatility arises, I will attempt to take advantage of the opportunities it creates. We will continue to invest with a long time horizon, and we will continue to invest like it is our own money – because it is. Thank you for the opportunity to grow your family capital alongside mine

Sincerely,

Scott Miller



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