ValueInvestor INSIGHT
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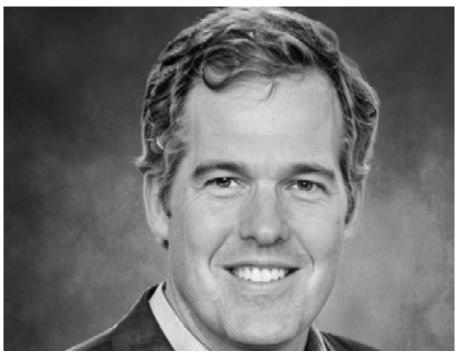
Getting Down to Business

Scott Miller of Greenhaven Road Capital describes how he targets companies that appear to be misunderstood by the market, why he has "different types of bets" in his portfolio, how he deals psychologically with highly volatile performance, and why he sees ample prospective upside in off-the-radar companies like Hagerty, Burford Capital and Cellebrite.

INVESTOR INSIGHT



Scott Miller
Greenhaven Road Capital

While competitive threats to fundamental equity investors proliferate, Scott Miller sees more upside than down: "The market is polarized, with short-term quant traders on one end and closet indexers on the other," he says. "This should create opportunity for deliberate, bottom-up investors who think about stocks as businesses managed by people and with stories that evolve over years."

Focusing on smaller and what he consid-ers misunderstood companies, he's seeing unrecognized value today in such areas as specialty insurance, litigation funding and law-enforcement software.

March 30, 2024

You describe looking to invest in "a mix of high-quality companies that can compound earnings over the long term as well as special situations that provide idiosyncratic exposure." Why that mix?

Scott Miller: The basic concept is tried and true, going back to Warren Buffett's early partnership where he talked about owning "generally undervalued securities" and "work-outs." I want to have different types of bets embedded in the portfolio.

The high-quality companies are competitively advantaged and well run, with typical characteristics such as secular industry tailwinds, low customer churn, positive product lifecycle dynamics, operating leverage driving higher profitability, and strong balance sheets. I'd like to own the companies for at least five years to benefit from the compounding of value over time. We own 10 to 15 stocks at a time, with the top five usually making up around 70% of the total. Those that matter most usually fall in this high-quality bucket.

My first week in the business I was handed Joel Greenblatt's book, *You Can Be A Stock Market Genius*, and have always been a fan of his advice that if you spend your time on situations not closely followed by other informed investors, your chance of finding bargains increases. The opportunities in spinoffs, restructurings, recapitalizations and other special situations are still there. They're episodic, more catalyst driven and shorter-term in nature, but they complement the portfolio by offering additional ways to win.

One would be hard pressed to find an S&P 500 company in your fund. What's a good representative example of what you consider a high-quality business?

SM: Par Technology [PAR] sells vertical market software for the food-services industry. Their toehold was in providing a cloud-based point-of-sale system to fast-food restaurants, and through their own development and M&A have added software to manage loyalty programs, payments, back-office administration and online ordering. Their products are designed to work independently but generally work better if used in conjunction with other Par software.

This is a jockey bet on CEO Savneet Singh, who since 2019 has streamlined the company and taken it from $1 per share in annual recurring revenue to one that should end 2024 with more than $8 per share in recurring revenue, against a current share price of $45. The customer churn on its core point-of-sale product is less than 5% per year, providing a very solid base to layer on new products to cross-sell, giving the company a long growth runway and lowering the difficulty of the dive in underwriting the idea.

What in your experience tends to be going on at companies that makes their stocks more likely to be misjudged?

SM: A common situation is when a business is going through a transition and the historical numbers don't well reflect the future. One new idea for us is Louisiana-Pacific [LPX], which in its legacy business is the largest producer of oriented strand board [OSB] used primarily to build homes. The commodity end of that market is feast or famine, with highly variable prices that are low when volumes are low.

The company is doing two things that should make it a better business. They have developed more value-added OSB, which can now be used in roofs, improves energy efficiency, and sells at higher prices. They have also been converting commodity OSB plants to those producing siding for homes. Siding is a higher-margin business and the economics of converting an OSB mill to a siding mill are outstanding.

Overall we believe there's a long runway for the company to reinvest in the business at high returns. On that point I'd mention that the management team here strikes us as uniquely skilled in capital allocation. Typically when companies generate a ton of cash – which happened here during the pandemic when OSB prices went through the roof – they try to empire build. Louisiana-Pacific bought back 50% of the shares outstanding. When they have attractive opportunities to reinvest, as they do now, they'll do that.

We think the stock today [recently at just under $84] sells for around the replacement value of the assets. As the margin profile and business mix improve, we think there's material upside in the shares from both earnings growth and re-rating.

Another example of a transitioning company we own would be IWG [London: IWG], the largest operator of co-working space in the world. The decline of WeWork has taken some irrational pricing out of the market, but more interesting is that the company is transitioning to a "partnerships" business model, where it partners with landlords looking to turn vacant space into revenue-generating shared working space. The landlord retains ownership of the space and assumes all the expense of building it out, while IWG serves as the property manager in the same way Hilton manages hotels for hotel owners.

Given high vacancies in the office market and increasing demand for more flexible space, we think the partnership model makes a lot of sense and that as IWG continues to sign new deals – there were 840 new partnerships signed last year, on the way to 1,000 or more this year – this eventually changes its profitability profile significantly for the better. As this initiative gains traction it will take time for the locations to be upgraded and the new space to be filled, so while we're not seeing the benefits of the transition in the financials yet, we're confident we will. If that happens, we wouldn't expect the shares [now around £1.95] of what will be a less cyclical and less capital-intensive business that is growing to trade at only 5x consensus forward EV/EBITDA, as it does today.

What originally attracted your attention in specialty insurer Hagerty [HGTY].

SM: When hundreds of companies were going public through SPACs a few years ago we were open to the idea that maybe two or three or five might be interesting. Hagerty was one of those, and what stood out about it was that State Farm, the largest U.S. auto insurer, invested $500 million in the SPAC deal at the offering price of $10 per share, and that Markel already owned 25% of company and was putting another $30 million into the deal. Two sophisticated insurance companies investing significant dollars in another insurance company got our attention.

The company specializes in a niche category, classic and collectible cars. It insures everything from 100-year-old cars requiring a crank to start, to Mazda Miatas from the 1980s, to modern "super cars" like McLarens and Bugattis that are still in production. The nature of the owners and how they use the cars translates to Hagerty's numbers, with loss ratios – the amount paid out for claims relative to earned premiums – in the low-40s, vs. 70% or more for the typical auto insurer. You might think that profit pool would get competed away, but it hasn't, which speaks to the difficulty and specialized knowledge required in underwriting and servicing insurance on these types of cars. In fact, a significant majority of the company's business comes through partnership agreements with nine of the top ten auto insurers who enlist Hagerty to price and service policies for their customers on classic and collectible cars.

McKeel Hagerty has run the company as CEO for more than 20 years, growing it from a family business with 30 employees

Scott Miller

What Matters

While intrigued with investing growing up, Scott Miller took a circuitous route to becoming a portfolio manager. Stops along the way included running a family-owned paper-bag factory, earning an M.B.A. and master's degree in education from Stanford, early-stage social-impact investing, and co-founding a thriving company focused on early childhood education.

Eventually, he says, "I found myself thinking about my portfolio when I was walking my dog or brushing my teeth and decided I wanted to do this for a living." He raised some money from family and friends and to build the partnership published his quarterly letters online, one of which prompted an e-mail from famed value investor Chuck Royce, who made an anchor investment in his fund. He still shares office space with the Royce family office.

"As an operator I came to see how much people matter," he says. "They're hiring, they're selling, they're allocating capital. If we can invest with the right people in the right businesses that have long runways, that's far more important than the short-term minutiae that investors seem too often to spend their time on."

to one with close to 2,000 today. He continues to build out the company's ecosystem around classic cars, with media properties, a valuation platform, a membership club, car shows, and more recently the development of an auction business. In partnership with Markel, they have a thriving reinsurance business. We think McKeel is a unique talent – if he were to leave for any reason we probably would too. Given that his family owns 50% of the company, I think this will be his life's work.

What do you think the market is missing in pricing the shares today at $9.15?

SM: Out of either lack of interest or lack of understanding, we don't think the market recognizes the growth potential Hagerty has from a variety of sources, including premium increases, a significant expansion in the State Farm partnership, increasing traction in the marketplace business, and a higher contractual profit participation from the reinsurance partnership with Markel. With operating leverage to the bottom line, we believe EPS can grow in excess of 30% per year for the next five to seven years.

We estimate earnings three years out at about $1 per share. The sell-side thinks a reasonable multiple here is 18x, which would result in the share price doubling from today. If we're right about the growth potential, however, the stock will deserve a much higher multiple than 18x.

Why are you high on the investment prospects for litigation finance company Burford Capital [BUR]?

SM: Burford was founded in 2009 and is now the largest provider of up-front capital to clients to fund litigation expenses. It finances commercial litigation – not personal injury – in exchange for a portion of the payout if the lawsuit is successful. Their share varies depending on the structure of the engagement, but the typical take is somewhere around 30%.

This is essentially an asset management business. Historically the "deal pipeline" came from law firms looking to get their legal work paid for by Burford so that clients were more likely to pursue cases. Now large companies are increasingly coming to Burford for financing that allows them to pursue large cases without hurting current-year earnings and executives' related bonuses. They agree to finance less than 5% of the cases brought to them.

The track record here since the company went public 15 years ago has been excellent. They break down their historical outcomes as settlements, which happen 70% of the time and generate positive if not spectacular returns; wins, that happen 22% of the time and generate the highest returns; and losses, which make up only about 8% of deployments and obviously detract from returns. That's all translated into a total annual shareholder return, including dividends, of around 20% since the company when public in 2009.

We could imagine due diligence here on the existing "portfolio" of cases isn't easy.

SM: It is difficult to value in a detailed way the full portfolio of cases, but there's considerable information on the largest ones, and for the smaller ones we're confident from management's track record that the returns earned in the past should be rep-

INVESTMENT SNAPSHOT

Hagerty
(NYSE: HGTY)

Business: Provider of insurance, valuation, auction, community-building and other services primarily to the "67 million Americans who self-describe as car enthusiasts."

Share Information (@3/28/24):

Price	**9.15**
52-Week Range	7.52 – 10.36
Dividend Yield	0.0%
Market Cap	$774.6 million

Financials (TTM):

Revenue	$1.00 billion
Operating Profit Margin	(-2.7%)
Net Profit Margin	1.6%

Valuation Metrics
(@3/28/24):

	HGTY	S&P 500
P/E (TTM)	98.0	23.5
Forward P/E (Est.)	47.7	21.6

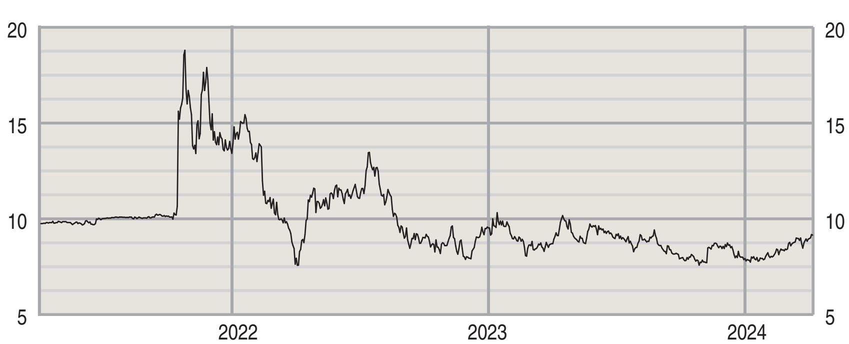
Largest Institutional Owners
(@12/31/23 or latest filing):

Company	% Owned
State Farm Insurance	59.1%
Polar Capital	5.8%
Neuberger Berman	4.0%
Markel-Gayner Asset Mgmt	3.5%
Vanguard Group	2.4%

Short Interest (as of 3/15/24):

Shares Short/Float	1.4%

HGTY PRICE HISTORY



THE BOTTOM LINE

Starting from its unsurpassed expertise in insuring classic and collectible cars, the company is successfully building out an "ecosystem" business with much higher potential growth than the market seems to contemplate today, says Scott Miller. At 18x his earnings estimate three years out, the share price would then be at roughly twice its current level.

Sources: S&P Capital IQ, company reports, other publicly available information resentative of those earned in the future.

The company's biggest potential win ever is still playing out. It has funded a long-running case against the government of Argentina, which privatized the YPF oil company without providing compensation to shareholders. Last fall a judge in New York ruled in favor of the YPF claimants in every way possible, resulting in an award that puts Burford's share at $6.2 billion, which is accruing interest at over $300 million per year. Argentina has a history of trying to avoid paying in similar cases, but it often has paid in the end. We think it's likely Burford eventually collects, but even if it's at a discount to the current award level, the returns would be eye-popping relative to the $38 million cost basis it has in the case, and against the current market value of $3.4 billion.

An even bigger commitment on its part, Burford over several years has spent $300 million so far to fund price-fixing litigation against a number of large food producers in the U.S., including Cargill, JBS, Tyson Foods, Smithfield and Pilgrim's Pride. The litigation is at all different stages, already including several settlements, but we believe we have enough to go on to calculate a present value of the damages paid to Burford at approximately $7 per share, 45% of the current share price.

How are you thinking about upside for the stock at today's price of $16?

SM: Based on the company's proven ability to generate cash and reinvest it at high returns, we believe on a discounted cash flow basis that what we're calling the core business of financing litigation – excluding YPF and the food case – is worth at least the current stock price. There is also an asset-management arm, with nine private funds and $3.4 billion in assets, that we value at $3 to $4 per share. What's left then are what we consider the "power-law" blockbuster cases, which today are YPF and the food litigation. We don't think the market is ascribing any value to those, which we expect will ultimately turn out to be very short-sighted.

There was a high-profile short report on Burford by research firm Muddy Waters five years ago. Have the issues raised around that been fully resolved?

SM: The essence of the report was that the company overvalued claims it still had in the pipeline and that there were less-than-transparent related-party transactions involving the CFO. Much of it all didn't turn out to be particularly meaningful, but it did highlight the differences in how ongoing litigation claims can be valued. Reasonable people can differ on that, which is one reason we think there's opportunity in the stock.

From litigation finance to digital forensics, describe your investment case for Israel-based Cellebrite [CLBT].

SM: Cellebrite has an interesting provenance in that it is based in Israel and had been owned by a publicly traded Japanese company called Sun Corp., which in 2021 took it public through a SPAC transaction in an effort to highlight its value. What caught our eye was the attractiveness of the underlying business and that the company had been cash generative for

INVESTMENT SNAPSHOT

Burford Capital
(NYSE: BUR)

Business: Founded in 2009, global provider of capital to finance a wide range of commercial litigation activities in return for a negotiated share of any resulting financial awards.

Share Information (@3/28/24):

Price	**15.97**
52-Week Range	7.10 – 17.70
Dividend Yield	0.8%
Market Cap	$3.43 billion

Financials (TTM):

Revenue	$1.09 billion
Operating Profit Margin	58.9%
Net Profit Margin	56.2%

Valuation Metrics
(@3/28/24):

	BUR	S&P 500
P/E (TTM)	5.8	23.5
Forward P/E (Est.)	16.1	21.6

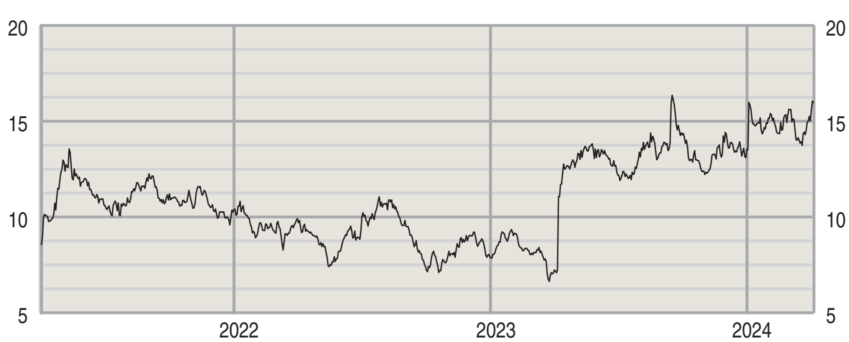
Largest Institutional Owners
(@12/31/23 or latest filing):

Company	% Owned
Mithaq Capital	8.5%
Columbia Mgmt	4.2%
Invesco	4.1%
Pictet North America	3.5%
Teacher Retirement of Texas	3.1%

Short Interest (as of 3/15/24):

Shares Short/Float	0.6%

BUR PRICE HISTORY



THE BOTTOM LINE

While the company has a strong record in financing commercial litigation for a share of future payouts, investors seem hesitant to believe that record will continue, says Scott Miller. He believes the market is ascribing no value to two blockbuster cases that together can yield per-share proceeds to the company well in excess of the current stock price.

Sources: S&P Capital IQ, company reports, other publicly available information

INVESTMENT SNAPSHOT

Cellebrite
(Nasdaq: CLBT)

Business: Sale and maintenance of software services used to help law enforcement agencies collect, process and interpret evidence from cellphones and other digital sources.

Share Information (@3/28/24):

Price	**11.08**
52-Week Range	5.22 – 12.50
Dividend Yield	0.0%
Market Cap	$2.27 billion

Financials (TTM):

Revenue	$311.5 million
Operating Profit Margin	16.8%
Net Profit Margin	(-26.03%)

Valuation Metrics
(@3/28/24):

	CLBT	S&P 500
P/E (TTM)	n/a	23.5
Forward P/E (Est.)	34.8	21.6

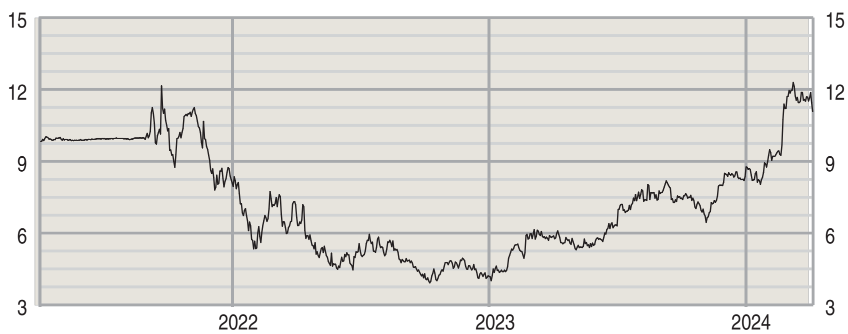
Largest Institutional Owners
(@12/31/23 or latest filing):

Company	% Owned
Sun Corp	46.6%
True Wind Capital	6.5%
Israel Growth Partners	5.2%
Clal Financial Mgmt	3.5%
Phoenix Investments	2.0%

Short Interest (as of 3/15/24):

Shares Short/Float	4.7%

CLBT PRICE HISTORY



THE BOTTOM LINE

With pricing power and continued product and service innovation, Scott Miller believes the company can increase its annual recurring revenues for some time at a 25% annual rate. He expects to benefit commensurately as a shareholder from that growth and believes the company will eventually be bought at a significant premium to its current ascribed value.

Sources: S&P Capital IQ, company reports, other publicly available information

more than a decade. It was also interesting that Axon Enterprise [AXON], a well-informed eventual potential buyer of Cellebrite, took a 5% stake in the SPAC.

The company's primary products enable law enforcement agencies at the federal and state levels to extract and analyze data from cellphones and other electronic devices. As our digital lives and actual lives converge, accessing digital information is critical when solving crimes and building criminal cases. A cellphone holds a wide range of information, including data trails on where a person has been, texts, e-mails, photos, contacts and search histories that can help build a very robust profile of what's transpired. Law enforcement refers to the cellphone as the "silent witness" because of all that it contains.

Accessing this information can be challenging, rightly so, given the security on phones. Cellebrite's solutions vary by model and operating system, but at this point the company can extract data from more than 30,000 different variations of phones. Once a phone is "cracked," the terms of a search warrant typically restrict what data can be accessed legally, and an audit trail must be maintained to show what information has been accessed, by whom, and if and how it has been shared. Then there's the challenge of making sense of the accessed data, making connections between people, and building a timeline of events. All of this is digital and Cellebrite is one of only two top providers of tools to execute and manage the entire process. The main competitor is Magnet Forensics, which is owned by the private equity firm Thoma Bravo.

While there aren't a lot of new law-enforcement agencies being created, we think the company has considerable potential to raise prices and to introduce new products that improve efficiency. There's often a backlog of phones for Cellebrite to extract data from, and its fees are typically 1/10 of 1% of an agency's budget. We believe there's a sustainable path to 25% annual growth in recurring revenues.

What do you think the shares, now at $11, are more reasonably worth?

SM: For vertical-software companies with this type of growth profile, we think it makes sense to value the shares based on annual recurring revenue. Cellebrite's shares trade at an enterprise value of less than 5x that number, a discount to the peer-group average and less than half the multiple at which acquisitions in the space have been done.

If the company can grow recurring revenues at the 25% rate we believe it can, we don't think the multiple will contract from here and we'll get paid on the growth of the business. What I ultimately think happens is that they're bought out at a significant premium to today's price by a strategic buyer like Axon or a financial buyer with an interest already in the space like Thoma Bravo.

We wanted to ask about your experience investing in cannabis-related companies. This was a relatively popular bet a couple years ago, but much less so now. Any lessons learned from that?

SM: It wasn't a huge bet for us and while it didn't work out, I don't consider it a huge analytical error. We invested in a basket of companies selling cannabis in the first quarter of 2022, not predicated on a strongly held belief in the benefits of marijuana, but much more on the cynical belief that a broken regulatory framework that distorted the earnings of cannabis companies would be fixed. With 18 states at the time having legalized cannabis, we expected federal laws that have punitive tax and other ramifications for cannabis producers to be relaxed in a way that improved the growth, profitability and valuation of companies in the value chain.

While I 100% believe those things are going to change and the economics are going to improve, it hasn't happened. We obviously could have done a better job assessing the timing, and when we decided we shouldn't try any longer to handicap when things would change, we moved on to what we thought was the lower hanging fruit that was increasingly available as 2022 went on.

Your strategy has proven quite volatile from a performance perspective. How do you manage through that psychologically?

SM: I took a psychology test once that indicated I'm comfortable having a highly divergent opinion, which certainly comes in handy when the market goes against us as it did, for example, in 2022. Smaller, misunderstood companies were a painful place to be as investors went risk-off and multiples compressed, compounded by the fact that the companies' underlying fundamentals often weren't immediately obvious enough to market participants.

What I always come back to is the core idea that fundamentals matter. If I'm right on those, maybe the market doesn't recognize them as soon as I'd like, but I believe it ultimately will. The successes or failures of our investments are not going to be tied to the multiples at which they trade at any given moment, but rather to the success of the underlying businesses being built hire by hire, product by product, and customer by customer. As long as I feel the business building is all on track – which was almost universally the case in 2022 – that keeps me grounded regardless of what's happening in the overall market. VII