

July 2023

Dear Fellow Investors,

The Fund¹ returned approximately 8% net in the second quarter, bringing YTD net returns to approximately 25%. Returns may vary by fund and investment class – please check your individual statements.

We continue to be faced with a wall of worry decorated by the war in Ukraine, a short-lived coup in a nuclear superpower, economies digesting a very rapid rise in interest rates, and inflation above the Federal Reserve’s stated target of 2%. When I allow myself to watch CNBC, I rarely come away optimistic, yet when I look at our portfolio, I am. Despite the challenges, I think our portfolio is a little stronger with each passing day. My mantra is “one day closer.” Even if the Fed is raising rates, even if the jobs report is weak, I tell myself that we are “one day closer.”

Investing in public companies can be psychologically draining. Share prices change minute by minute or even second by second, usually influenced by factors other than what is fundamentally happening inside the company. It takes years to design, build, and launch a new product, but a P/E multiple can change in a second. Ultimately, 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.

Companies report their results every 90 days and often are intentionally opaque about their future. For competitive reasons management teams are often coy about future products and strategies. The share price *can be* an indicator of the health of a company, but is often not a good predictor. There are times when companies are thriving but their share prices are flailing for external reasons, and vice versa. Over the longer term, I consider business fundamentals much more important than short-term sentiment or gyrations in the multiple.

One Day Closer

In this letter, I will lay out a mosaic of our top holdings, how they are improving, and what I believe will ultimately drive their success or failure. Some of our companies are on a path of simple, discreet, quickly executed improvements, while others are on a longer path. In aggregate, I think the companies we own are well-suited to navigating the wall of worry. While a recession in which GDP declines 1%, 3%, or even more would not be good for our companies, I believe fundamental progress should continue. A recession, when it eventually comes, will likely provide a headwind to growth, but 15%+ growth should not turn negative, new products should not cease, and competitive advantages should not evaporate.

I believe that with each passing day we are “one day closer.” These improvements will not always be reflected in share prices, and many times progress will not be linear, but time is the friend of a strong management team, and time is the friend of the competitively advantaged businesses. Time is our friend.

Hagerty (HGT)

Let’s start with an example of a company we own that’s pursuing several initiatives that will very likely yield a stronger business with the passage of time. As we have detailed in past letters, Hagerty focuses on the classic car industry. Their

¹ Greenhaven Road Capital Fund 1, LP, Greenhaven Road Capital Fund 1 Offshore, Ltd., and Greenhaven Road Capital Fund 2, LP are referred to herein as the “Fund” or the “Partnership.”

primary source of revenue (and profits) today is related to insurance. Classic cars represent an attractive niche in the insurance industry. People take care of their toys, and because an accident can impact resale values, they often do not claim damages to their insurance companies. The net result is that for every dollar taken in as revenue, Hagerty pays out only 42 cents to cover damages, compared to an industry average greater than 70.

The largest auto insurer in the U.S. is State Farm. They invested \$500M into Hagerty at the IPO (technically de-SPAC transaction) and another \$75M this past quarter. State Farm sits behind the Hagerty family and global specialty insurance provider Markel as the largest shareholders of Hagerty. This year, the Hagerty and State Farm IT systems will be sufficiently integrated and tested such that Hagerty should start onboarding 480,000+ State Farm policies. The onboarding is contractual and in both parties' best interest. Every day is one day closer to transitioning the State Farm relationship from a cost center (setting up the systems) to a source of growth and profits. The State Farm partnership coming online is not a question of if; it is a question of when. The partnership will be profitable... the question is, how profitable?

Reinsurance is another of Hagerty's paths to improved earnings that will just take time. The reinsurance business is very profitable, and their subsidiary HagertyRe has the option to buy out their partner Markel's remaining 20% stake. Right now, HagertyRe benefits from Markel's credit rating. As it establishes its own investment grade rating, HagertyRe can exercise its option on Markel's remaining interest for \$23M, and that one-time capital outlay should generate an incremental \$16M+ per year in profits. Hagerty should make that investment all day long when the time comes.

Other initiatives that will take time to be fully reflected include two rounds of layoffs that should accelerate profitability while still investing in growth (revenue grew 30% last quarter). I think operating margins in 2024 will exceed 7% and continue to expand as growth initiatives are realized. Hagerty is also making a large investment in creating an online marketplace for classic cars. This should be a wonderful asset-light business over time that has the added benefit of cross-selling insurance policies to the new car buyers. The business is nascent but will compete with Bring-A-Trailer, which transacted ~\$1.4B of vehicle value in 2022. Hagerty's online marketplace quadrupled during the second quarter. It is being built listing by listing, feature by feature. One day at a time....

The share price of Hagerty has declined modestly during our ownership, but the business has undoubtedly gotten bigger and stronger. The founding family owns ~51% of the company, so they care. They have grown it from a small business operated by their parents out of their house into a company that employs 1,800 people and should generate ~\$1B of revenue this year. Eventually the multiples should stop compressing and we will get paid on the growth in revenues and profits, so we wait. Every day we are one day closer to State Farm, one day closer to owning all the reinsurance business, one day closer to a robust marketplace – and all the while the core business continues to grow 10%+ organically. Eventually the progress will be represented in the share price. Math is math.

Lifecore (LFCR)

The payoffs may be quicker at Lifecore, a specialty contract development and manufacturing organization (CDMO) with expertise in highly viscous liquids and packaging into pre-filled syringes. Their business benefits from secular tailwinds and has additional capacity coming online. I wrote about Lifecore in the “elephant hunting” section of the last letter, mentioning that it had very interesting potential but that it was a small position because there was the possibility of substantial loss of capital. At the time, the company was in violation of its debt covenants, and it was unclear how much value would be available for the equity holders (us). Fast forward three months and the debt situation has been resolved by \$150M in financing from their largest customer, Alcon, which also pledged significant new business that likely soaks up

much of the oncoming capacity. When a customer provides financing to a supplier, it offers some indication of how much they value the relationship (or need it) and how high the switching costs are.

Activists have been involved with Lifecore for years, noticing the gem of a CDMO business inside a conglomerate that grew avocados and made packaged foods such as salsa and guacamole. Over time, the activists got board representation and, finally, everything but the CDMO business was sold. Now Morgan Stanley has been retained to sell the remaining CDMO business.

Historically, there has been a robust market for CDMOs at multiples higher than where Lifecore currently trades. In a normal business environment, I think we could see a purchase price more than double the current share price. Will potential buyers give credit for oncoming supply? Will they apply historical multiples in a higher interest rate environment? It is impossible to say with certainty, but, with each passing day, we are likely one day closer to the sale of Lifecore. If the company does not sell, earnings should grow, Alcon's new business will come online, and secular tailwinds persist. Are we going to care less about the safe manufacturing of drugs? Are we going to make the FDA process easier? Lifecore benefits from these trends

Ultimately, I think it is a question of whether we get paid quickly or slowly on Lifecore. Gun to my head, I think the company gets sold for a healthy premium before the end of the year. In the meantime, as the business has been de-risked (debt situation resolved) and the new business from Alcon announced, shares have appreciated above \$10 per share vs. our \$5 cost basis. It's not an elephant yet, but that represents a lot of progress with line of sight to a potential exit. So, we wait for the process to proceed.

Sphere Entertainment Co. (SPHR)

Sphere Entertainment Co. may also have a potentially quicker path to appreciation. A new holding outlined in more detail in this letter's appendix, Sphere has many ingredients for mispricing including sold assets, spun-off assets, a unique business model, and widely misunderstood financials.

Was spending six years building a \$2.3B concert and movie venue in the desert a good idea? I don't know, but paying pennies on the dollar four months before the slated opening is almost certainly a better idea. I think there is a path, over time, to significant appreciation. The laughingstock construction project may even become the #1 destination in Las Vegas with 40M+ visitors per year. As the narrative changes, so, too, might the multiple.

With the passage of time, what happens for Sphere? It goes from an over-budget, behind-schedule punchline to an operating business. The building will open at the end of September with U2 playing 25 sold-out shows. When the outside of the building was turned on in July, SPHR shares appreciated by 25% in short order. The video is worth watching ([link](#)) to get a sense of the display surface that will show advertisements. In the next few months, one might see the company sell naming rights, announce new musical residencies (Phish is MSG CEO James Dolan's favorite band...), and they will begin showing their new IMAX-like movie on their screens. We are one day closer to the building opening. In the meantime, this is as close as you can get to the inside of the building ([link](#)).

Barnes & Noble Education (BNED)

Barnes & Noble Education runs bookstores in partnership with colleges. They are going through a business transformation to a model they call First Day Complete – a partnership with the colleges where all course books are billed through the

school for a flat fee per student. For schools that have transitioned, BNED revenue increases by 90% and gross profits grow by 130%. This fall, the number of First Day Complete schools will grow by more than 50% but the total will still be less than 25% of the overall schools.

In the last letter, I wrote that, “as best as I can tell, the number of people modeling the company’s economics if they are successful with the First Day Complete transition is tiny.” To my knowledge, it was three people consisting of an activist who then joined the Board, and two investors I found on Twitter using pseudonyms. In an effort to both grow the number of people trying to model this nanocap and to check my assumptions, I tweeted that I was starting a Barnes & Noble Education modeling group. It has been surprisingly productive. The number of people who have actually modeled the company has multiplied.

I remain convinced that there is a legitimate path to well over \$100M per year in EBITDA for this sub-\$70M market cap company. This coming year will be a challenge since not enough schools have transitioned to First Day Complete and there is debt to be refinanced, but I see a path to an 8-10X return from here if the debt gets restructured, allowing the equity holders to realize the benefits of First Day Complete. Each passing day we are a day closer to the First Day Complete transition and a properly capitalized business.

Digital Turbine (APPS)

It is an understatement to say that the past year-plus has been frustrating for Digital Turbine shareholders (us). It has become a smaller position through price declines and sales of shares as uncertainty increased on both the potential for new initiatives as well as their timing.

I often reflect on what went wrong. How did this go from a growth stock to a value stock? There have been two causes, in my opinion. The first is that their product delivering content (not apps) on phones lost T-Mobile as a customer – sometimes we are one day closer to a bad outcome: the loss of a customer. The second, and bigger issue was with their SingleTap product. SingleTap is a technology that “enables smartphone users to instantly install an app to their Android device with a single tap...bypassing the noise of the app store environment, and dramatically increasing conversions.” The higher conversion rates mean lower costs per app install or app opening.

Digital Turbine was monetizing this technology on their own networks. They could deliver app installs for less because of their higher conversion rates. It was a lower margin business, selling an app install for \$3.50 but buying \$3.20 in advertisements to do so. Revenue grew very quickly, which was rewarded when the market wanted to see revenue growth. The company (and I) believed that licensing the technology to the likes of Facebook, Snap, and Twitter was a path to greater profitability and, ultimately, a better, more scalable business. At their 2021 investor day, the company indicated that they were very close to having a few major players integrating SingleTap into their platforms, making investors salivate. Unfortunately, not only did none of the platforms adopt SingleTap in 2022 but scaling back the internal SingleTap business and losing the T-Mobile business caused revenue declines.

Finally, SingleTap should have its day in the sun. Facebook’s European product announcement included a feature that sounds identical to SingleTap (I believe it is SingleTap but Facebook is white labeling the feature and Digital Turbine is not allowed to name Facebook publicly as a customer). Additional rollouts will likely include Microsoft. It also seems likely that Digital Turbine will power an alternative app store for Verizon. Digital Turbine has done a wonderful job of benefiting from partners’ scale. This tiny company works with Verizon, AT&T, Samsung, and América Móvil, to name a few. The

downside of these partnerships is that Digital Turbine is rarely in charge of timing, and often legally restricted in what they can say or announce. For example, it is highly unlikely that DigitalTurbine will put out a press release or formally announce the launch of Facebook as a partner. However, it appears that a series of large partnerships are on the horizon and we may be rewarded from here for our patience.

Burford (BUR)

Burford is an asset manager that focuses on litigation finance (funding lawsuits). Their historic investments have generated IRR's approaching 30%. If those rates persist, profits simply grow with the passage of time and the power of compounding. Burford has a case referred to as YPF that could easily be worth more than the current market capitalization of the entire company. Over the next year, there should be greater clarity on the size of the award and the event path for ultimate collection – see [our Q1 letter](#) for more detailed discussion in the appendix. Over the next couple of years, it is likely that Burford will be included in passive indexes such as the Russell 2000, bringing a wave of forced buyers. The earnings for Burford will be lumpy as the timing and sizes of litigation awards are difficult to predict, but this is the scaled player in a niche industry with limited competition and a history of attractive returns that are not correlated to the overall economy. Every day we are one day closer to some or all of YPF, and the company continues to compound balance sheet capital at high rates. Again, time is our friend. This is the scaled player in litigation finance and the business has gotten stronger and stronger over the past five years and, in my opinion, the value of pending cases and their earnings power are not reflected in the share price – yet.

Top 5 Holdings

Apart from the previously-discussed Lifecore, the remainder of our top five holdings have fewer short-term catalysts. They benefit from long-term secular trends and I believe they are very likely to grow revenue and earnings at attractive rates for years and years.

APi Group (APG) – APi Group has a wonderful asset-light fire/life safety business whose services are required by law to be purchased by their customers. This business has grown at high single digits organically with incremental growth coming from tuck-in acquisitions. With very low customer churn for their non-discretionary services, APi revenues and earnings should grow with the passage of time. 2024 earnings should benefit from the resolution of supply chain issues and APi's full digestion of its large acquisition of Chubb. There is also a strong argument for multiple expansion as similar asset-light, predictable, organically growing, cash-flow-generating companies trade for significantly higher multiples. Over time, I believe, the combination of revenue growth, expense normalization, and multiple expansion could yield a share price that is 50-100% higher than current levels. Time is our friend, and I believe we are one day closer to the market appreciating the quality and earnings power of this former SPAC.

Cellebrite (CLBT) - Cellebrite develops technology to assist law enforcement in extracting data from cellphones. They also have products to review and analyze the data and document the chain of evidence. Digital evidence is only becoming more important in investigations and is generally impossible to access without tools from companies like Cellebrite. The company has a strong product pipeline that should drive cross-sells and upsells. Another industry participant just raised prices by 40%, which presumably provides a pricing umbrella under which Cellebrite can raise its own prices over the next year. Additionally, a private-equity- firm (Thoma Bravo) bought out Magnet Forensics, their much smaller competitor, for \$1.3B at 10X 2023 revenues. CLBT currently trades at approximately

4X revenues, so multiple expansion is a real possibility. With each passing day, the stigma of being a SPAC reduces and the strength of the business shines through. I see a clear path to growing revenues by 20% and profits even faster.

KKR (KKR) – The firm has been growing AUM in the mid-teens for decades. They are adding new products to appeal to the large pots of money directed by insurance companies, while also building out their offerings and personnel to go after high-net-worth investors, which currently make up less than 5% of AUM. In the short term, there will be fewer realizations (sales of companies), which will impact short-term distributable earnings, but as one of the handful of global private equity companies with a stellar brand and track record, it is highly likely with each passing day that more assets are raised. In the meantime, they have over \$100B in “dry powder” that will be called from investors and invested/added to fee-paying AUM when KKR believes the time is right.

PAR Technology (PAR) – This is another company that has undoubtedly gotten better and stronger with the course of time, but little has been reflected in the share price (yet). With each day, we are one day closer to launching their Menu product in the U.S. and their table service point-of-sale (POS), both representing very large opportunities for the company. It is increasingly likely that the company completes another accretive acquisition and divests their defense business, creating a pure play software company. We are also one day closer to the company achieving profitability, which should happen by the end of 2023 or beginning of 2024. A more speculative prognostication is that the company may win a large chain restaurant like Burger King, which has historically developed and maintained their own POS. Were that to happen, Burger King would imply 50% growth in the POS store base. PAR has a dynamic team. If the multiple stops compressing, we should do quite well as their core software business should grow 25% per year for the foreseeable future.

SHORTS

To date this year, our short positions have not been a source of returns. Fortunately, our individual short positions are typically small. The shares of our flying taxi company have appreciated significantly, detracting from our returns. While time is the friend of the advantaged business, I suspect that over time a combination of technology risk (no working product), regulatory risk (not currently approved), and business model risk (unclear if they can make money even if product is developed and approved) will eventually catch up to this “high flyer” (pun intended).

Similarly, the valuation of a high-end EV manufacturer continues to confound. During the quarter, the company delivered 1,400 cars. Not 1,400 per day or per month – that is for the quarter. Not surprisingly at such a small scale, the unit economics were terrible. Given the intensifying competitive landscape and pricing pressures, it will take a lot of “one day closers” to grow into their \$14B valuation. We are also short a company to create a “stub” position. Finally, we are short an American manufacturing company that specializes in piping and should face a significantly more intense competitive landscape. We are currently also short a couple of the major indices.

RECENT SALES

In the first half of the year, the Fund sold out of several securities, including Elastic (ESTC), Patrizia (PAT), and Clarus (CLAR). In the case of German real-estate-focused private equity firm Patrizia, I sold in order to reinvest that capital in



Burford, which is also a Europe-based asset manager focused on litigation. Our shares of Patrizia had appreciated and, ultimately, the risk/reward looked more attractive at Burford. However, I would not be surprised if we end up owning Patrizia again in the future. We also sold our shares of Clarus, which had appreciated quickly. We took the “win” and harvested profits to re-deploy capital into the very attractive opportunity set in front of us.

Elastic was also difficult to part with – I think there is so much to like – but we needed to fund purchases in companies like Lifecore and Sphere, which I think could have significantly greater upside in the medium term and I think could be less susceptible to the gyrations caused by changes in market multiples.

OUTLOOK

This letter has focused on improvements at the company level. While new macro economic issues will undoubtedly flare up, they always do. I believe we are one day closer to resolving the banking issues in the US and one day closer to interest rates peaking. As macro environments go, the waters ahead appear less choppy than the waters we have navigated.

This year, the U.S. market returns have been driven by seven or eight technology stocks. In the last five years, domestic small caps have gained ~4% annually, about one-third the rate of larger stocks. In fact, we are 10 years into a cycle of larger cap stocks outperforming small cap stocks. While these cycles have tended to last 10 years in the past, this one could persist for longer. There is nothing magical about the 10-year number, and nothing that prevents us from buying Microsoft at 12X sales while growing 6% or Nvidia at more than 60X sales, or Apple at 33X earnings with declining sales. We could. However, I continue to believe that the law of large numbers will catch up to the largest companies, and smaller companies will have their turn.

We own a collection of businesses that should grow and prosper over time. If multiples just stop compressing, we should do quite well since we own a number of companies that are growing revenues and profits at 20%+. If multiples ever expand, that will be a cherry on top.

At the Berkshire Hathaway annual meeting this year, Warren Buffett said, “[t]he world is overwhelmingly short-term focused, and if you go to an investor relations call, they’re all trying to figure out how to fill out a sheet to show the earnings for the year. And the management is interested in feeding them expectations that will slightly be beaten. I mean, that is a world that’s made to order for anybody that’s trying to think about what you do that should work over 5 or 10 or 20 years.”

We are playing the long game. I appreciate your patience. Every day, I think we are One Day Closer.

Sincerely,

Scott



APPENDIX - Sphere Entertainment (SPHR)

NOTE: This section is intentionally blank, the writeup has only been distributed to existing limited partners.

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