SILVER RING
VALUE PARTNERS

April 11th, 2020

Dear Partners:

I hope that you are well. I greatly appreciate the confidence that you have placed in me by entrusting me with your capital, and I appreciate your continued support. At the end of Q1 2020 the **portfolio was very attractively priced, with the Price to Base Case value ratio at 46%.** The portfolio had 15 investments, cash at 0% and option-adjusted net exposure at 57% at the end of the quarter. The ratio of Price to my estimate of Normalized EPS was 5x for a collection of businesses that I expect to grow profits at low-single digit rates on average over the long-term. Importantly, I believe that **the hedges that I had in place *prior* to the onset of the current crisis have both served us well and are likely to continue to protect us** from the brunt of what could well be a very severe decline in the markets.

Partnership Performance			
	Last 12 Months	Since Inception (9/1/2016, Cumulative)	Since Inception (9/1/2016, Annualized)
Silver Ring Value Partners (Net)*	**-3.8%**	**4.4%**	**1.2%**
Average Cash Levels	5%	25%	25%
Average Option-Adjusted Net Exposure	72%	62%	62%
Russell 3000 Index	**-9.1%**	**24.1%**	**6.2%**
MSCI World Index	**-9.9%**	**17.5%**	**4.6%**

*Results are net of all fees and expenses and use the 20% performance fee level above a 6% hurdle that represents the substantial majority of partnership assets over these periods
Partnership Results are audited through 12/31/2019 and unaudited afterwards

Calm ***temperament***, disciplined adherence to my ***investment process***, and thoughtful ***risk management*** are never more important than in the middle of a crisis such as the one that we find ourselves in now. The human toll from the Coronavirus pandemic is substantial. The economic and financial impact of the shock from our society's attempt to overcome the virus has the potential to be massive even with maximum government support. Or the world might take a much more benign path, with a mild recession and a quick recovery. There is no way to be sure at this point. It is easy to be overwhelmed with emotions and behavioral biases in such a moment; but that will not lead to the best decisions. It is more important than ever to calmly stick to my well-practiced investment process to help us ride out this storm. In the absence of clairvoyance about the future, I have, and will continue to position our portfolio to weather the full range of possible outcomes – the essence of managing risk.

I would be remiss if I didn't **thank you, my partners**, for doing your part in contributing to our success. Unlike the situation faced by many other investment managers, ***none* of you expressed concern** about your investments or ask for my time (which has distracted many an investor from their investment work). Rather, **a number of you have made additional subscriptions to the partnership** as the opportunity set became more attractive, while others sent in their expressions of support. We have an unusual group of individuals and organizations that are able to act rationally with a long-term time horizon in mind, and that is a big part of our competitive advantage.

Executive Summary

At the end of Q1 2020 the **portfolio was very attractively priced, with the Price to Base Case value ratio at 46%.** The portfolio had 15 investments, cash at 0% and option-adjusted net exposure at 57% at the end of the quarter. My investment decisions are driven by bottom-up considerations, and cash is a residual of that bottom-up investment process. I do not seek to time the market, and I continue to rigorously stick to my criteria for quality and discount to intrinsic value.

	Portfolio Holdings			
			3/31/2020	3/31/2020
	Security		% Portfolio	% Delta-Adjusted
1	COVETRUS INC	CVET US	16.6%	16.6%
2	DISCOVERY COMMUNICATIONS-C	DISCK US	13.9%	13.9%
3	Owens-Illionois Position		15.2%	12.8%
	OWENS-ILLINOIS INC	OI US	14.6%	14.6%
	Owens-Illinois May 2020 Put Option, Strike = $7 (hedge)		0.6%	-1.8%
4	Cintas (CTAS) May 2020 Put Option, Strike = $200		3.3%	-12.7%
5	Hopes and Dreams Puts (TSLA, ROKU, SNAP, WORK, BYND Put Options, Jan 2021)		6.8%	-11.7%
6	Gilead Sciences Position		4.2%	10.7%
	Gilead Sciences (GILD) Jan 2022 Call Option, Strike = $52.5		4.2%	10.7%
7	CHARLES & COLVARD LTD (previously Undisclosed Postion #2)	CTHR US	10.7%	10.7%
8	Tail Risk Hedge (MAT, TEVA, HTZ, NFLX and THC Put Options, Jan 2021)		4.6%	-9.5%
9	Undisclosed Position 4		8.1%	8.1%
10	ARCADIS NV	ARCAD NA	6.2%	6.2%
11	FOX CORP - CLASS B	FOX US	5.5%	5.5%
12	EBay Poisition		0.6%	2.4%
	EBay (EBAY) Jan 2022 Call Option, Strike = $33		0.6%	2.4%
13	CAESARS ENTERTAINMENT CORP	CZR US	1.5%	1.5%
14	MEDIFAST INC	MED US	1.2%	1.2%
15	BERKSHIRE HATHAWAY INC-CL B	BRK/B US	1.1%	1.1%
	All Investments		99.8%	56.9%
	Cash & Equivalents		0.2%	

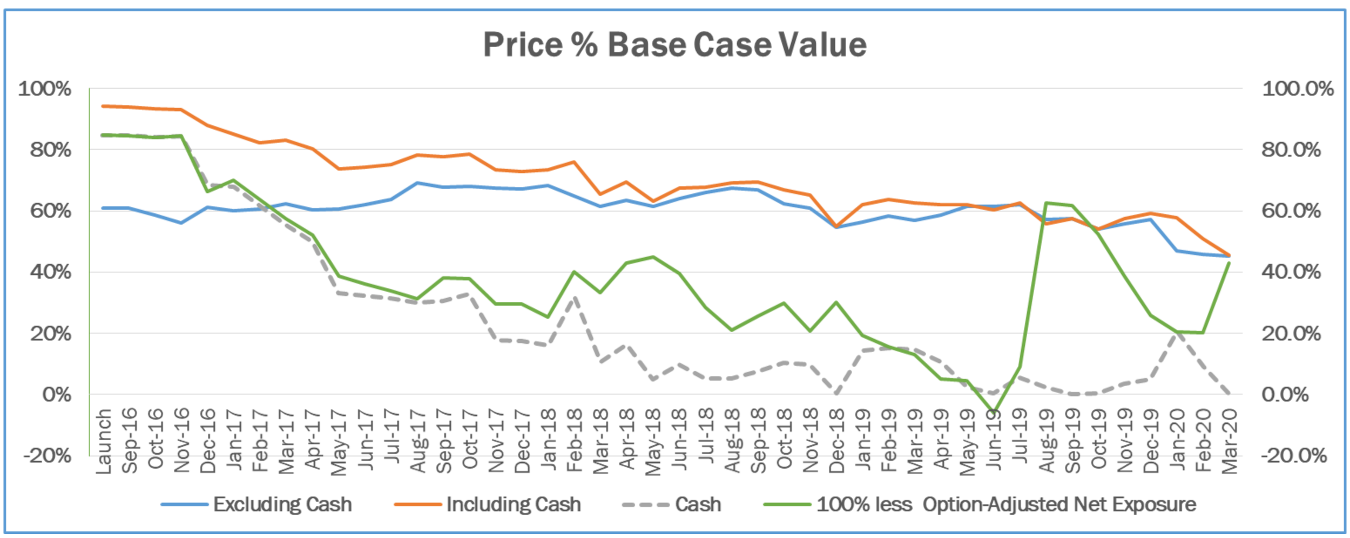
Investment Activity

I made the following changes to the portfolio since the last quarterly letter:

- Early in the quarter and ***prior* to the market sell-off I initiated the "Hopes and Dreams" put option basket** in 5 companies that are on average money losing enterprises trading at 10x+ revenues and priced for a very unlikely positive tail outcome. The position size for the basket was **2% at cost**, had a January 2021 expiration and was structured to provide **10x+ returns** if valuations for these companies were to come down to earth.
- **Increased Covetrus (CVET) from a Small to a Medium** position size
- Sold the put option hedge on Covetrus (CVET) as the balance sheet risk had been substantially lowered
- The put options on Royal Caribbean (RCL) expired worthless in January. I did not roll them over again as I had already committed the full 2% that my risk management process allows for this investment. Sometimes discipline hurts.
- **Sold the Caesar's (CZR) put option portion of the Tail Risk basket** because the stock and option price implied that the company's takeover by El Dorado was going to fall through, and my analysis suggested that with committed bank financing in place and the seller committed to the deal that probability was low.
- **Bought a 1% position in Caesar's (CZR) as a merger arbitrage** with expected returns between 100% and 200% within a year for a deal that my analysis suggests has a high probability (but not a certainty) of closing
- Began building a position in **Berkshire Hathaway (BRK/B), starting a 1% position** during the quarter
- Began building a position in **Medifast (MED), starting a 1% position** during the quarter
- **Added to Owens-Illinois (OI)** as the stock price went down to Maintain a Medium size
- **Added to Charles & Colvard** (previously **Undisclosed Position #2)** as the stock price went down to maintain a Medium size
- **Added to Undisclosed Position #4** as the stock price went down to maintain a Medium size
- Made small additions to the Mattel (MAT) and Netflix (NFLX) put options that are part of the Tail Risk put option basket at prices that met the original criteria for purchase
- Reduced the Cintas (CTAS) put option position by approximately a third as the stock price began to collapse and the position became a 5%+ position, up from the original 0.5%, which exceeded my risk management parameters
- **Sold a third of the Hertz (HTZ) put option component of the Tail Risk basket** as the option price implied a 60% probability of bankruptcy and the position size became large
- **Sold a third of the Gilead (GILD) call option position** as the stock price went up on Coronavirus remedy hopes and the price to value gap became narrower
- **Added to Fox (FOX)** as the stock price declined close to my Worst case to maintain a Small position
- Eliminated the remaining small Allergan investment as the price/value gap closed

Ticker	Company Name	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	1Q 2020	2Q 2020	3Q 2020
	Investment Thesis Tracker													
DISCK US	DISCOVERY INC-C													
AMT US	AMERICAN TOWER CORP													
INVA US	INNOVIVA INC													
CTHR US	CHARLES & COLVARD LTD													
GILD US	GILEAD SCIENCES INC													
CMPR US	CIMPRESS PLC													
ARCAD NA	ARCADIS NV													
GOG LN	GO-AHEAD GROUP PLC													
HIL US	HILL INTERNATIONAL INC													
CHUBA US	COMMERCEHUB INC-SERIES A													
RCL US	ROYAL CARIBBEAN CRUISES LTD													
AGN US	ALLERGAN PLC	Start->												
	Undisclosed 4				Start->									
OI US	OWENS-ILLINOIS INC					Start->								
EBAY US	EBAY INC					Start->								
FOX US	FOX CORP - CLASS B								Start->					
CRCM US	CARE.COM INC									Start->				
CTAS US	CINTAS CORP									Start->				
CVET US	COVETRUS INC										Start->			

- White: thesis is tracking roughly in-line with my base case
- Orange: thesis is tracking somewhat below my base case
- Red: thesis is tracking significantly below my base case
- Dull Green: thesis is tracking somewhat better than my base case
- Bright Green: thesis is tracking significantly better than my base case
- Black: Investment exited



- The portfolio is attractively priced at 46% of Base Case value
- Option adjusted net exposure is at 57%, reflecting option-based hedges

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Operational Update

- KPMG once again completed the audit and distributed the K-1s (available on SS&C's secure portal) in a timely manner in March
- I continued posting educational **investing videos** on my **YouTube channel**
- I wrote several articles on general investing-related topics at the ***Behavioral Value Investor***, a publication of Silver Ring Value Partners**, including**
    1. How To Invest Safely Amidst The Coronavirus Market Meltdown
    2. 5 Insights from Charlie Munger at the 2020 Daily Journal Annual Meeting

Portfolio Update

Investing Environment

How quickly things change. The long bull market was fun for many investors while it lasted. It was easy to do well. Buying high growth story-stocks was the pathway to riches. Profits? Free cash flow? Who needed those? It was frequently all about a rosy future which would justify almost any price. Ten times revenues? Fine. Fifteen? Why not. Just show us some nice metrics that are increasing rapidly every quarter.

To be fair, there were also many growing, high-expectations companies that *did* have good profits and free cash flow. This last bull market was different from the one in the late 1990s in that a number of very powerful business models emerged, in the process destroying or damaging others in their wake. The common thread though was that expectations were high for many, if not most, companies. Little thought was given to alternative scenarios where things would be less rosy or to risk of permanent capital loss. The biggest risk was perceived to be missing out – not keeping up with the stock market that was rapidly rising, fueled by inflated expectations, low interest rates and a long economic expansion.

That is all over now. The reason for the change was the Coronavirus pandemic and the economic cost of overcoming it that we are now facing. The reason though could have been something else and the outcome would have been similar. The investing landscape always oscillates between euphoria and fear, and long bull markets give way to bear markets where the paper profits of prior years' frequently evaporate. The cause of the shift is always different and always impossible to predict in advance, as is its timing. The fact that the shift always happens, however, is an endemic part of how markets work.

Now that we are in the midst of the Coronavirus-induced stock market sell-off, how should we proceed? The markets have been extremely volatile. Fear is rampant. Investors are reverting to their worst behavioral biases and habits in such an environment. You need to do better than the crowds and continue to invest rationally.

First, you need to think about events, including the coronavirus-induced market panic, in terms of *ranges*, not point outcomes. *Nobody* knows exactly how this will play out. However, we can bracket the vast majority of the probability between the following two scenarios:

A. **The Benign Scenario:** Coronavirus blows over in a few months as prevention measures and warmer weather help. We avoid a full-blown recession, most businesses recover by year-end, except perhaps a few of the most affected that take a bit longer. Markets stabilize and investing returns to normal.
B. **The Gloomy Scenario:** The health impact on our society is far more severe than we hope. The global economy is tipped into a deep, multi-year recession. This recession is accompanied

by an initial credit crisis that causes many financially levered companies reliant on the capital markets to go bankrupt. Many other companies' profit streams are depressed for many years to come. Stock markets spiral downwards for years before stabilizing.

You might say: "Wait a second. These are pretty different possibilities. How can I possibly prepare for both??" Exactly. Speculators bet on their ability to foresee specific future outcomes. Investors need to invest for the *full range of outcomes* and create a portfolio that meets their financial goals no matter what comes.

As of this time, the markets seem to be embedding in security prices an outcome close to the benign scenario described above. With the U.S. stock market off less than 20% from a starting point where most securities were expensive, market participants seem to for now believe that there will be little lasting damage to the economy or to most businesses. As an American I hope that they are right. As an investor who has been investing for two decades and has carefully studied the history of financial markets, I am skeptical that a shock to the economy of this magnitude will not result in far more depressed security prices. Whatever comes, I am ready, with a calm temperament which allows me to remain rational and a rigorous risk-management mindset which leads me to construct a portfolio that I believe should not do terribly in any environment and that should do very well in the most likely scenarios over the long-term.

Temperament

When potential clients ask me what my competitive advantage is, a big part of my answer is my temperament. That doesn't always impress them. Some would rather I had told them that I have some special satellite that allows me to see inside factories to predict quarterly production. What is temperament anyway, why does it matter, and how can we tell that yours is any good?

Temperament is the ability to stick to your best theoretical process under extreme pressure. Some people are great investors on paper. They can talk the talk. They have great PowerPoint presentations outlining their strategy. However, when markets go against them and their investments are marked down, these investors fall apart and deviate wildly from their communicated strategy. Their brain changes to its ancient, "reptilian," mode and is not able to follow through on the strategy that they have so eloquently conveyed to their clients just a short while ago.

If their process is only in action when everything is calm and easy, it's of limited use. The biggest opportunity for decisions to matter is when everything is going haywire and securities are priced at their most irrational levels. *That* is when their adherence to their process, assuming their process is good to begin with, matters most. Ultimately, it's what they will do under duress that will have an impact on their clients' portfolio, not what they say in polished communiques.

How can you tell if an investor's temperament is any good? You can't, until there is a period when there is great stress for that investor and you have a chance to observe how they *act*. Do they stay rational and execute their process? Or do they succumb to their insecurities and deviate, with perhaps some story explaining why they acted very differently from how their process suggested they should? Both investors with a good temperament and those without one will claim to have a good temperament. You should watch what investors *do* under stress and see if their actions are consistent with their stated process to decide for yourself.

Risk Management

Risk management will not produce the best returns.

What?? Then why do it? Because we don't know the future. Allow me to illustrate what I mean with an example using the current environment.

Let's suppose that we have three portfolio managers that each pursue a very different approach:

> **Cautious Claire:** Claire believes that the Gloomy Scenario described earlier is going to come to pass. She loads her portfolio with cash and extremely safe, but at best only moderately undervalued defensive stocks that can withstand any environment. If the world recovers quickly her results will be underwhelming, but she *knows* that's not the way things are going to play out, so that doesn't enter into her decision-making process.
>
> **Aggressive Anne:** Anne believes that the Benign Scenario described above is going to happen. She invests in every beaten-down stock that she can find that will benefit from a quick recovery, but which might go bankrupt if one doesn't happen. No matter, she is *sure* in her view of the path the world is about to take.
>
> **Prudent Paula:** Paula is not sure which of the two scenarios is going to come to pass. She wants ensure that her portfolio does at least OK no matter what happens, and does well in the scenario that she believes to be more likely. She constructs her portfolio with some very safe investments with a moderate amount of expected returns, combined with some aggressive investments that have more risk but that are likely to do much better in the Benign Scenario. As she searches for investment opportunities for her aggressive investments she does not necessarily pick those that can go up the most *if* the Benign Scenario were to come to pass, but also considers these companies' ability to survive if that scenario is delayed or not quite as benign as she had hoped.

Now, imagine what happens if each of the two scenarios actually comes to pass:

> **The Gloomy Scenario happens:** Cautious Claire looks like the paragon of investing wisdom. Magazines rush to interview her. She appears on cable news channels talking about her investment process. "How did you do so well when many others have come up short?" "Well, there was this one moment when I just *knew* how it was all going to play out. I sold all my old investments and prepared for Doom and Gloom. My clients have benefitted enormously, and

I have had an influx of new ones beating down my door to be able to share in the fruits of my wisdom in the future."

In the same articles and TV interviews where Cautious Claire's virtues are extolled, Aggressive Anne is mentioned in passing, derisively. "What was she *thinking?*" "Didn't she *know* we were heading for Doom and Gloom?" "How could she have done so poorly for her clients?"

Nobody mentions Prudent Paula at all. She did well, but her results didn't stand out compared to Cautious Claire.

The Benign Scenario happens: Aggressive Anne looks like an investing genius. Magazines rush to interview her. She appears on cable news channels talking about her investment process. "How did you do so well when many others have come up short?" "Well, there was this one moment when I just *knew* how it was all going to play out. I sold all my old investments and prepared for a quick recovery. My clients have benefitted enormously, and I have had an influx of new ones beating down my door to be able to share in the fruits of my wisdom in the future."

In the same articles and TV interviews where Aggressive Anne's virtues are extolled, Cautious Claire is mentioned in passing, derisively. "What was she *thinking?*" "Didn't she *know* we were heading for a quick rebound?" "How could she have missed such an amazing opportunity to make money for her clients?"

Nobody mentions Prudent Paula at all. She did well, but her results didn't stand out compared to Aggressive Anne.

What I hope the above imaginary example illustrates is that there is going to be a massive outcome bias after we know how this all plays out. The winner will write their narrative and imbue their sometimes just plain lucky outcomes with skill and foresight that wasn't really there at the time the decisions were being made. That won't matter, because most observers will be dazzled by their spectacular results relative to the rest of the field and will not question how well that same investor would have done *had the world taken a different path*.

There is only one problem. Right now, *before* we *know* how it is going to play out is when we have to make our decisions. **Betting on one particular macro outcome in a way that you will do really poorly if it doesn't occur is not investing; it is just speculating.** In the same way that casino gamblers don't know if the roulette ball will land on red or on black before the wheel is spun, neither can we be sure of how the world will play out during the current crisis.

If you are a serious investor and care about both preserving your capital and growing it at attractive rates over the long-term, the implication is clear: you need to construct a portfolio that doesn't do terribly in any outcome and that does well across many of the paths the world might take. In no path will your results, after the fact, be as attractive as if you had optimized your portfolio for that specific path. *That*'s why risk management does not produce the best returns. It is because as we manage risk we tax our outcome in each path to ensure that if the world takes a *different path* that we still do OK.

My Investment Strategy During This Crisis

So how can we ensure that we benefit from the extreme mis-pricings that are occurring during this crisis while still protecting our capital in case the external environment continues to get worse and the economy is in a recession for a long time? Let me first review the resiliency of the existing portfolio investments coming into this crisis, and then describe my approach for deploying capital in this environment.

Resiliency of the Current Portfolio

First, let's be clear – no company is completely resilient. The strongest business can eventually fail if the government shows up and forbids it by fiat from generating revenues. Some portion of each company's costs are fixed, and even if it starts in a net-cash position it *can, in theory,* eventually go bankrupt. Therefore, it is more helpful to think of resiliency as a continuum rather than a binary characteristic.

<u>Gilead</u> – The company is completely resilient and possibly anti-fragile. It has roughly zero net debt and barring socialization of medicine it should be able to generate large amounts of free cash flow regardless of the economy.

<u>Cintas Put Option</u> – anti-fragile. The company had moderate financial leverage, but it was a very expensive and over-valued stock of a cyclical company.

<u>EBay</u> – strong balance sheet, divestitures that are in the process of generating meaningful cash and a moderately cyclical business make this company very resilient.

<u>Discovery Communications and Fox</u> – I believe both companies to possess substantial resilience. Half their revenues come from recurring subscription fees with price escalators. Their margins are very high. They entered the downturn with balance sheets capable of carrying additional debt. Their advertising revenues are cyclical, and I would expect them to decline meaningfully in a recession. As a thought exercise however, Discovery Communications would have to have a greater than 60% full-year decline in advertising revenue before it would no longer be able to pay the interest on its debt from profits. I believe that these companies can weather a prolonged severe recession without going bankrupt or substantially impairing equity value.

<u>Arcadis</u> – The company's balance sheet was under-levered going into the crisis. Its projects are long-term in nature and are unlikely to be quickly cancelled. The nature of the business lends itself to a degree to remote work. The business is cyclical, so a prolonged recession would hurt demand, but the decline would have to be long and severe before the balance sheet were affected.

Owens-Illinois and Covetrus – both companies carry substantial debt. This is mitigated by the fact that their underlying businesses are very non-cyclical. OI makes glass bottles and jars for beverages and food. The company had its revenue decline by high single-digits *cumulatively* over the 2-year period of 2008-2009. Covetrus delivers vital medications to veterinarians (a business which grew through the last recession) and its online business would be a big beneficiary of a prolonged quarantine that would offset some decline in its distribution business. Yes, each of these companies in theory could go bankrupt because of their large amount of debt. My rigorous analysis suggests that this is very unlikely, but not impossible. This probability is further mitigated by our hedges on levered companies, discussed below, which are very likely to provide an offsetting benefit in the event that the environment gets severe enough for either OI or Covetrus to go bankrupt. It is hard to think of a scenario in which a recession forced OI or Covetrus to go bankrupt but Mattel or Hertz are not similarly impacted.

Charles & Colvard (previously Undisclosed Position #2) and Undisclosed Position #4 – both are micro-cap companies that operate in cyclical businesses. Each one entered the crisis with *no debt* and with meaningful *net cash*. Each company was free cash flow positive prior to the crisis. In a prolonged shut-down of the Western economy each company could turn cash flow negative, burn through its cash and go bankrupt. However, this would need to be a multi-year shutdown with no business allowed. My analysis leads me to believe that each business would survive a more normal, albeit severe, multi-year recession. The companies would also have the option to liquidate before such an environment played out with each company's current cash constituting either over 100% or a very substantial amount of its market cap.

Hedges

Our hedges are composed of the previously described Tail Risk basket, the recently initiated Hopes and Dreams basket, and the put option hedge on Owens-Illinois (OI). Collectively, all of these hedges cost us less than 5% of our capital. Depending on how things progress we might be able to get several multiples of that in return.

As a reminder, here is what I wrote in my Q3 2019 letter when I initiated the Tail Risk Basked:

> "The Tail Risk Hedge described below is not meant to protect the market value of our portfolio in a ~ 25% market sell-off, but rather in a far more catastrophic market environment. [...] I invested 2% of our portfolio spread approximately evenly across six companies. In theory we can receive up to 50% if disaster strikes and all six companies go bankrupt. That is of course not very likely. However, even if several of these companies were to run into serious trouble we are likely to receive a very meaningful return. What's more, **this capital would become available at just the time when bargains are likely to be plentiful.** This means that even if we get far less than the maximum return, its timing will allow me to create additional meaningful value for the partnership.
>
> My plan going forward to is to continue with the hedge as long as each of these companies still meet the original criteria for inclusion. If we start moving towards a scarier market environment, there is a possibility that this hedge will be marked to market at a much higher

> percentage of the portfolio. However, to make sure it truly serves its purpose I do not plan on selling these options until either they no longer qualify, their prices reflect most of the potential return that we would get from the issuer going bankrupt or their opportunity cost in terms of other investments is too compelling to pass up."

The Hopes and Dreams basket was initiated in January and February of this year, prior to the declines of the stock market and the spike in volatility. I describe it in-depth later in this letter. At a high level, it is a group of put options on very over-valued companies that are losing money and whose stocks are being priced based on hopes of a very optimistic outcome that is far from the most likely for each business. In a meaningful market sell-off I would expect the prices of such companies to decline as much as or more than the market, allowing us the option to redeploy the proceeds from these put options into bargain-priced securities.

The OI put option was bought when I increased the position size from Small to Medium to manage overall risk of the investment. Since then, the company's balance sheet has gotten somewhat stronger with a divestiture and internally generated free cash flow. Management also announced that as of early March it has not seen any impact on the demand for its products. I plan on liquidating this hedge prior to its expiration and redeploying its proceeds as I believe that OI's non-cyclical nature combined with the other hedges offer us sufficient protection at the portfolio level.

Deploying Capital

It is important to act both *deliberately* and *at a measured pace* in this environment. The first risk is of getting frozen by fear or analysis-paralysis and failing to act as events unfold quickly. The second, and opposite, risk is of acting too quickly by deploying every last dollar into cheap securities just to watch them drop precipitously further and not have any capital available to take advantage of the new opportunities.

My solution is to make changes in much smaller steps than before. Typically I would start with a position size for a stock that was at least 5%. I would do so all at once, liquidity considerations permitting. Now, I am moving much more incrementally, building that position slower, and dollar-cost-averaging. In a similar vein, as the hedges that I described in the earlier section go up in market value, I trim them very gradually. Doing it in such a way will not allow me to bottom-tick or top-tick any single security, but that is not the goal. What it will allow me to do is to continue to rationally deploy our capital, gradually but consistently, into very undervalued securities.

The partnership has two sources of incremental capital as market pessimism deepens. The first is new subscriptions that have been coming in, and of which I expect more to come in as the year progresses. The second source of capital is the higher market value of our put options, which I have been very slowly reducing as the market gets more and more pessimistic to produce capital during an environment of crisis and plentiful bargains, just as originally planned. **As the capital slowly comes in, I am deploying it into two categories of investments, the "Resilient" category and the "Aggressive" category, in a ratio of approximately 2 to 1.**

The "Resilient" category of investments are investments that I expect to not be impaired in valued even if the crisis takes an extremely unfortunate turn, with an accompanying deep and long recession. My usual purchase criteria apply (e.g. 65% of Base Case value for an Above Average business). An example in this category is my recent purchase of Berkshire Hathaway below Book Value described later in this letter.

The "Aggressive" category of investments are those that I expect to produce 3x to 10x+ returns *if* we avoid a very deep and long recession, but which might be impaired if we do not. The maximum that I would allocate to this category is 10% of the portfolio, keeping with my risk-management rule that I do not want any one judgement to impair more than 10% of the portfolio if it turns out to be incorrect. An early example of an investment in this category is the 1% position in the Caesar's merger arbitrage, which I expect to go up ~3x if the deal closes and the economy goes into a moderate recession, ~ 2x if the deal closes and we go into a severe recession, and to potentially go to zero in the unlikely scenario of the deal breaking and the economy going into a prolonged and severe recession. There will be other investments in this category which I expect to update you on in the next letter.

The overall point I want to leave you with is that the core of the portfolio will be investments which I believe will weather the storm no matter what and produce attractive long-term returns in most scenarios. Yes, some will get marked down temporarily due to fear, illiquidity, or both. However, I do not expect major permanent capital loss from that core of the portfolio. At the same time, we will be using a small portion of our capital to pick up amazing bargains which should all offer several *multiples* of return on our capital under many reasonable scenarios, but which in theory could face permanent capital impairment if the worst possibilities come to fruition. The magnitude of this impairment, even in the worst case, should be mitigated by the long-term results of the core of the portfolio allowing us to achieve our goal of at least OK results in any scenarios and hopefully very attractive results in many scenarios.

Alternative Approaches

There are two other ways one might handle the uncertainty that we face in the current environment. I have considered both and decided that the approach that I outlined above is better suited to our objectives.

1. <u>Hold a lot of Cash</u> – An alternative to owning investments with high expected returns and some risk + hedges is to hold cash and wait for even better bargains. As I write this, we are not yet in an environment where very strong companies with fortress balance sheets are meaningfully undervalued. Some argue that would be a true sign of the bottom, and that holding cash now would allow one to skip the more difficult opportunities. The problem in passing on excellent opportunities to wait for even better ones is that the latter might never materialize. I have always told you that top-down market timing is not something that I have any skill in nor is it something that is part of my approach. This has not changed.
2. <u>Own Great Businesses with Fortress Balance Sheets</u> – This would allow one to not worry about any of this and observe the rest of the market participants' frenetic activity from a

position of complete indifference and perhaps amusement. That sounds very nice. The problem is that such businesses are not very meaningfully undervalued at this time. If anything, they have been bid up in some cases by scared market participants looking for havens in a storm. Sure, if this ends up being the next Great Depression, this approach might seem wise in hindsight. However, I do not believe it is the best approach across the full range of possible scenarios that we might face.

Portfolio Activity

Due to the length of this letter and a larger number of smaller changes, I am going to keep the explanation of a few of the changes brief. That is not because of lack of thought that went into the decision or lack of transparency – feel free to reach out if you have questions about any of the investments.

Hopes and Dreams Put Options Basket

Early this year I continued to be very uncomfortable with how expensive the stock market was, the complacency of investors and the resulting high expectations implied in many securities. I decided to see if I could find specific stocks that met the following criteria:

- Had losses or very scant profits
- Were trading at a high multiple of sales
- Had a story perceived as exciting by the market
- Had business models that I could easily imagine either disappearing or being much smaller at maturity than the story suggested
- Had long-term options available
- I could buy January 2021 put options at a price offering ~ 10x returns to December 2018 lows (as a quick proxy for what some fear could do to these stock prices).

These criteria largely steered me away from many enterprise technology subscription models which had strong staying power and where it was hard to tell whether these were amazing businesses at a very early stage of growth or unrealistically priced companies that were unlikely to meet high expectations. Conversely, in consumer-facing companies there were a number to choose from. This is because it is much easier for a business to "die" or see drastically decelerating growth when selling to consumers who face lower switching costs and who have to make new purchase decisions every time than it is for those with recurring revenues selling to enterprises.

The general idea was to find companies which were priced for near-perfection – for hopes and dreams of a spectacular future outcome that was neither realistic nor supported by the evidence. The plan was to deploy 2% of the portfolio with a 10:1 risk/reward.

I was able to find 5 companies that met my criteria:

- **Snapchat (SNAP)** – Would anyone be truly surprised if in 5 years this company didn't exist?
- **Tesla (TSLA)** – When I bought the put options in early February, the stock price was over $900 per share. To justify this price it would have to have Toyota-level profits in ~ 5 years (and Toyota has ~ 25% market share). Maybe, but probably not.
- **Beyond Meat (BYND)** – I know people swear by the product, but the company would have to grow exponentially for a long time to justify their valuation at the time, while other large and small companies try to displace them.
- **Roku (ROKU)** – It's not clear to me why in 5 years the functionality provided by them, aggregating all kinds of video offerings, will not be offered for free by the cable providers.
- **Slack (WORK)** – Microsoft had just released a *free* product, Microsoft Teams, which had the potential to make Slack unnecessary. What's more, this product was going to be automatically installed as part of regular Microsoft updates, as I discovered when my computer rebooted and forced me to explore this new functionality.

Yes, it is *possible* that all of these companies will meet their lofty expectations. However, history suggest that it is very unlikely. More often than not, when the stock market prices securities for near-perfection, it results in broken dreams among those speculating on future outcomes not supported by the evidence at hand.

Covetrus (CVET)

I covered the initial thesis in-depth in the Q4 2019 letter. Since then, a few positive things have happened:

- Core North American distribution revenues have stabilized
- Management familiar with the animal distribution business was appointed to run the North American division
- The company got debt covenant relief for a year
- The SaaS business, Vets First Choice, continued to meet or exceed expectations, growing revenues 30%+ and continuing to add new practices at a healthy clip
- The company sold a non-core EU diagnostics business for over $100M, providing a nice liquidity cushion

These factors combined made me decide that the balance sheet was in a much better place since the risk of a rapid sales decline has meaningfully decreased and cash availability was higher. Given the unique nature of the investment (it's not often that you find 2 businesses for the price of 1, especially when one of them is healthy and growing rapidly) I decided that a Medium position was appropriate and the put option hedge no longer necessary.

As the crisis unfolded in late February and March, the stock sold off to levels well below my Worst Case. I continued to act rationally, in accordance with my process, and kept adding at much lower prices to bring the position size back to the Medium, 10% size.

Owens-Illinois (OI)

I kept adding to the investment to restore the Medium position size as the stock price declined well below my Worst Case. I believe my balance sheet analysis to be correct and the company will be able to withstand the current downturn. Furthermore, the company provided an update in early March saying business has not been affected thus far. It provided another update in early April saying that the quarter is tracking to a Q1 sales decline of less than 1%, and that the last 2 weeks in March, the period most affected, saw sales off by 7% y/y.

The company has ample liquidity, and at these levels of declines (or even somewhat higher ones) for a *full year* it should be able to survive a recession without substantial value dilution. It is possible for the company to go bankrupt given its debt levels, but it is very unlikely. Furthermore, an economic environment that causes such an event is also very likely to cause a bankruptcy for Hertz and Mattel, two components of the Tail Risk hedge basket of put options, offsetting at least some of our losses on OI in this unlikely event.

Charles & Colvard (CTHR, previously Undisclosed Position #2)

I am disclosing this investment as having crossed the 5% ownership threshold I have had to file a form 13G. The investment combines a floor value provided by asset value with a potential for very large upside if the business turns around. I plan to go into more detail in a future letter, but the general facts are:

- The company sells jewelry utilizing moissanite, a close substitute for diamonds
- The stock trades at a discount to a conservative liquidation value (see below)
- There have been several indications of traction in the turnaround
- If the turnaround succeeds, it is possible to have returns in the 3x-10x range given the size of the market vs. the size of the current market capitalization of the company
- The CEO appears honest and competent
- The Chairman owns a substantial stake in the business
- The company has no debt and has recently turned FCF-positive
- There are many reasons why the turnaround might fail (synthetic diamonds, lower-priced Chinese competitors, and many others). I estimate the probability of the turnaround fully succeeding at under 50%. Despite this, the combination of the downside protection offered by asset value and the potential upside in the event of success create a positively skewed asymmetric risk/reward profile which I believe to be very attractive.

CTHR Liquidation Value Analysis			
	Assets/(Liabilities)	Adjustment	Adjusted Asset/(Liability)
Cash & Equivalents	13.3	20%	10.7
Accounts Receivable	3.1	20%	2.5
New Inventory (after 2015)	29.3	25%	22.0
Old Inventory (2015 and earlier)	6.4	50%	3.2
PP&E	1.1	75%	0.3
Accounts Payable	(4.8)	0%	(4.8)
Accrued Expenses	(1.5)	0%	(1.5)
NAV			**32.3**
per share			**1.04**
Recent Price			$0.67
Price % Liquidation Value			64%
Return to Liquidation Value			**57%**

Gilead (GILD)

I sold roughly 1/3rd of our call option position in Gilead after the stock spiked on hopes that it will benefit from being a provider of a Coronavirus drug. My value for Gilead is in the $90s, far above where the stock was trading prior to the spike and still above where it was trading at the time of the spike. I have no idea if their drug will or will not be approved for Coronavirus, and if approved if they will be allowed to charge a reasonable price or if social pressure will lead to confiscation of their intellectual property. My sale was due to a desire to manage risk in a position that was getting large in terms of Portfolio at Risk and the opportunity cost presented by more attractive investments. I would continue to hold the remaining 2/3rds even if I were *sure* that their Coronavirus drug were destined to fail, as I believe the stock is still meaningfully undervalued without it.

Berkshire Hathaway (BRK/B)

I began building a position in Berkshire Hathaway during the quarter. It is part of my “resilient” group of investments that I described earlier in this letter. If there is any company that has the financial staying power to weather a prolonged crisis, Berkshire is it. I made the purchase close to Book Value for a business that is worth substantially more. I made the purchase at ~ 65% of my Base Case value and with ~ 20% downside to my Worst Case.

Medifast (MED)

This is a company that I had done substantial research on and that was in my inventory of ideas prior to the crisis. The basic business is selling to people who are busy and want lose weight a meal replacement plan combined with support from a “coach” who has recurring conversations with them throughout the process. What makes this not a multi-level marketing (ehem, pyramid) scheme is that the coaches, while they do sell to the clients, do not hold the inventory and just direct the clients to the company site. The key to this plan is the combination of tasty, convenient nutrition that works with the support from the coach. Some percentage of the clients become coaches, and the flywheel continues to work with the company growing the number of coaches and the number of end clients. The company has no net debt, meaningful cash, positive FCF and was trading at 7x my estimate of normalized EPS at the time of purchase. When I bought the stock in the midst of March's sell-off it was at ~ 50% of my Base Case value estimate. The story is not without risk as there have been some recent execution issues that management is addressing, but the risk/reward ratio is very attractive and the business, which is mostly online, should be resilient to a prolonged shutdown of the economy should one occur.

Caesars Entertainment (CZR)

CZR was part of my Tail Risk put option basket. It is in the process of being acquired by El Dorado for $8.40 in cash and .09 shares of ERI (which was trading north of $60 prior to the crisis but sunk below $10 at a point during March). My put options had a strike of $8. The idea was that in a credit crunch the deal might break due to lack of financing.

During March the put options spiked as CZR stock fell, and began to imply that the deal would break. On the other hand, management of the acquirer announced that 1) they had financing already committed by the banks and that 2) they were not backing out of the deal. Given that the banks couldn't pull out and the acquirer wasn't trying to use the Material Adverse Change (MAC) clause to get out of the deal, my analysis led me to believe that the probability of the deal breaking was small. I therefore sold our options with the stock around $8 for a substantial profit.

Of course, the markets have a way of having their own way, and within a few days the stock was below $5 as market fears snowballed. With perfect foresight it would have been nice to wait for that before selling my puts, but thinking that way would be succumbing to hindsight bias. I believe I acted rationally and correctly based on available information when I did it. More importantly, I bought a 1% position in CZR as a merger arbitrage with a price of ~ $4.50. I was being offered 2x-3x return in less than a year on a deal that I believe has a high probability of closing. All that is left in the way is a couple of state approvals being delayed because of the disruption caused by our response to the Coronavirus. Of course, the deal may still break, but I believe the risk/reward was very favorable.

Performance Discussion and Analysis

I encourage you to consider the results summarized below in conjunction with both the investment thesis tracker as well as the discussion of the individual companies in this letter. Price volatility usually far exceeds the changes in underlying business values, especially during a crisis.

Any investment process that is judged over less than a full economic and market cycle is liable to appear better than and worse than it really deserves at different points. When markets are going straight up, risk management and careful attention to valuation might look like an unnecessary drag on returns. On the other hand, when security prices are collapsing across the board, it might temporarily seem like we are permanently losing capital while in reality we are not. The benefit of measuring results over a full cycle is that it allows us to better separate the skill with which an investment process is applied from the violent fluctuations of prices caused by a manic market.

Performance Analysis (3/31/2020)		
	Last 12 Months	Inception - 12/31/2019 (cumulative)
Net Return (after all fees)*	**-3.8%**	**4.4%**
Hurdle Rate of 6% per year	6.0%	23.2%
Russell 3000 (total return)	-9.1%	24.1%
MSCI World Index (total return)	-9.9%	17.5%
Average Cash & Equivalents % Portfolio	**5%**	**25%**
Average Option-Adjusted Net Exposure**	**72%**	**62%**
Contribution to Gross Return (before all fees)		
Positions (including equities and options that were part of each position)		
Allergan Plc	7.0%	7.2%
Hopes and Dreams Put Options	5.0%	5.3%
Cintas Put Position	4.6%	4.9%
Tail Risk Hedge	4.2%	4.5%
Arcadis NV	2.3%	3.2%
Gilead Sciences Position	2.0%	-0.1%
Care.com (previously Undisclosed Position 5)	2.0%	2.2%
American Tower Position	0.5%	4.5%
Caesars Entertainment	0.4%	0.4%
Medifast	0.2%	0.2%
Berkshire Hathaway	0.1%	0.1%
eBay Inc	-0.6%	1.0%
Covetrus Inc	-1.4%	-1.5%
Royal Caribbean Position	-1.4%	-2.3%
Fox Corp	-1.7%	-1.9%
Charles & Colvard (previously Undisclosed Position 2)	-4.1%	-2.4%
Owens-Illinois Inc	-5.8%	-6.1%
Undisclosed Position 4	-6.7%	-11.4%
Discovery Communications Position	-8.2%	-5.2%
Cimpress NV		2.6%
Hill International (previously Undisclosed Position 3)		1.3%
Go-Ahead Group		0.5%
CommerceHub Inc		1.6%
Innoviva (previously Undisclosed Position 1)		2.4%

* Performance fee is presented based on the Founder's Class, which reflected the majority of the assets during these time periods

** Option-Adjusted Net Exposure adjusts for the use of options by replacing their weight with the delta-adjusted notional value for each option. While imperfect, it takes into account both the use of put option hedges and the presence of long-term call options

Disclaimers: Please see the "Disclaimers" section at the end of this letter

Your Questions

As I have committed to do in the Owner's Manual, I will use these letters to provide answers to questions that I receive when I believe the answers to be of interest to all of the partners. This quarter I received one question that I thought it would be helpful to address in this letter. (Please keep the questions coming; I will do my best to address them fully.)

What caused your ~10% decline in February? Was it due to any particular holdings or across the board?

Some of it came across the board with no specific news (e.g. Discovery Communications and Fox). Cheap stocks can always get cheaper, regardless of their underlying value. Market participants frequently ask the question of "What happens next?" instead of "What is this business worth?" In this case, the (reasonable) fears of a recession prompted a sell-off to very unreasonable prices.

The second category of decline came from my two micro-cap stocks which both got hit very hard. Both have no debt, meaningful cash and positive FCF. One is trading at a large *discount* to a conservative liquidation value estimate. The other is trading not too far from cash value and significantly below my worst case. Small, illiquid companies tend to decline much more than large and liquid ones in a market sell-off. That only matters if we are forced to sell or if their value becomes impaired. We are fortunate to have arranged our affairs not to have to be forced sellers by avoiding portfolio leverage and having a stable and long-term capital base. As to potential value impairment – that is possible if the Western world remains shut down for an extended time, a scenario that I believe to be unlikely. In a normal, but severe, recession each business's base case value is likely to be reduced somewhat, but nowhere near where the stocks were/are trading.

The third source of decline is the two companies that we own with high financial leverage, OI and CVET. In both cases I had done a very robust stress test, assuming that an '08-'09 level recession hits right away, and I believe both would be fine. The companies are both very *non-cyclical*, which is a large part of what makes me comfortable with their balance sheet. Each is trading between 1/4th and 1/3rd of my Base Case value and both are below my worst case value. Yes, it is possible that in some Great Depression-level recession both would go bankrupt. In addition to that being unlikely, we would also be to a significant degree protected by the hedges in our portfolio, which include put options on highly levered companies which are also likely to go under in such a scenario.

These declines were partially offset by the hedges, which are working as intended. Remember that I had an intentional low "attach" point in order to guard against a 35%+ meltdown, not against a 15%-25% one to give us large catastrophic protection rather than an "extended warranty" type of policy. I believe if the markets melt down a lot further from here these hedges will spring into action much more meaningfully than they have thus far.

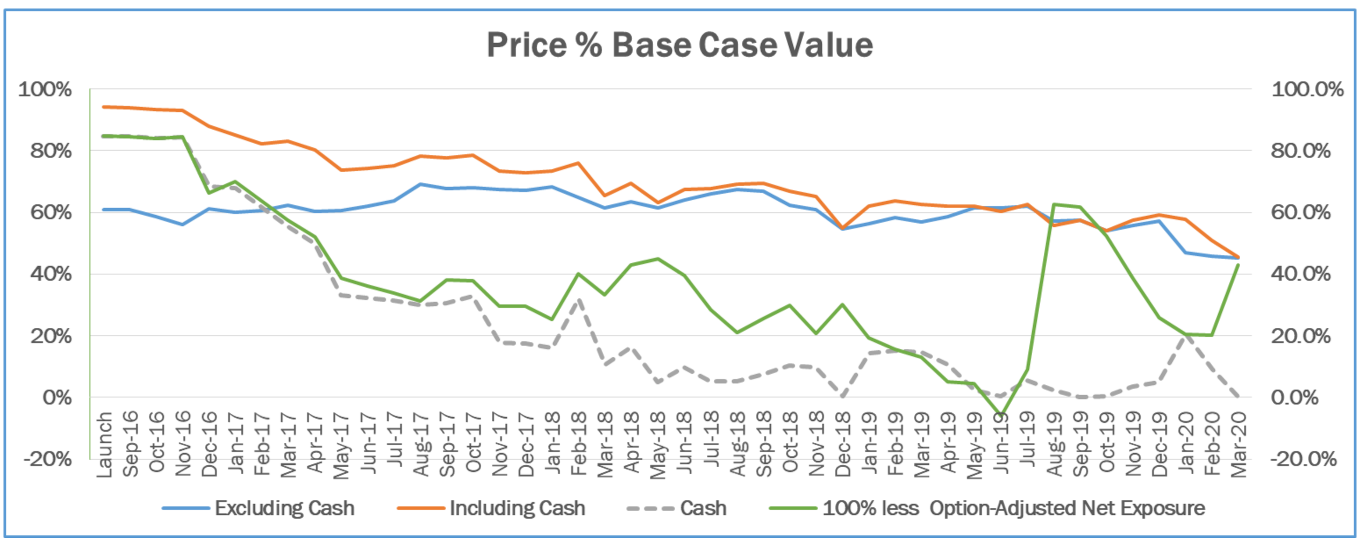
All that being said, cheap stocks can temporarily go much cheaper. The last thing I would want to promise you is that there won't be further mark to market declines. I do promise you 100% effort using a process that I know works and my family's capital alongside yours.

Portfolio Metrics

I track a number of metrics for the portfolio to help me better understand it and manage risk. I track these both at a given point in time, and as a time series to analyze how the portfolio has changed over time to make sure that it is invested in the way that I intend for it to be. Below I share a number of these metrics, what each means, and what it can tell us about the portfolio. As time passes, you should be able to refer to these charts and graphs to help you gain deeper insight into how I am applying my process.

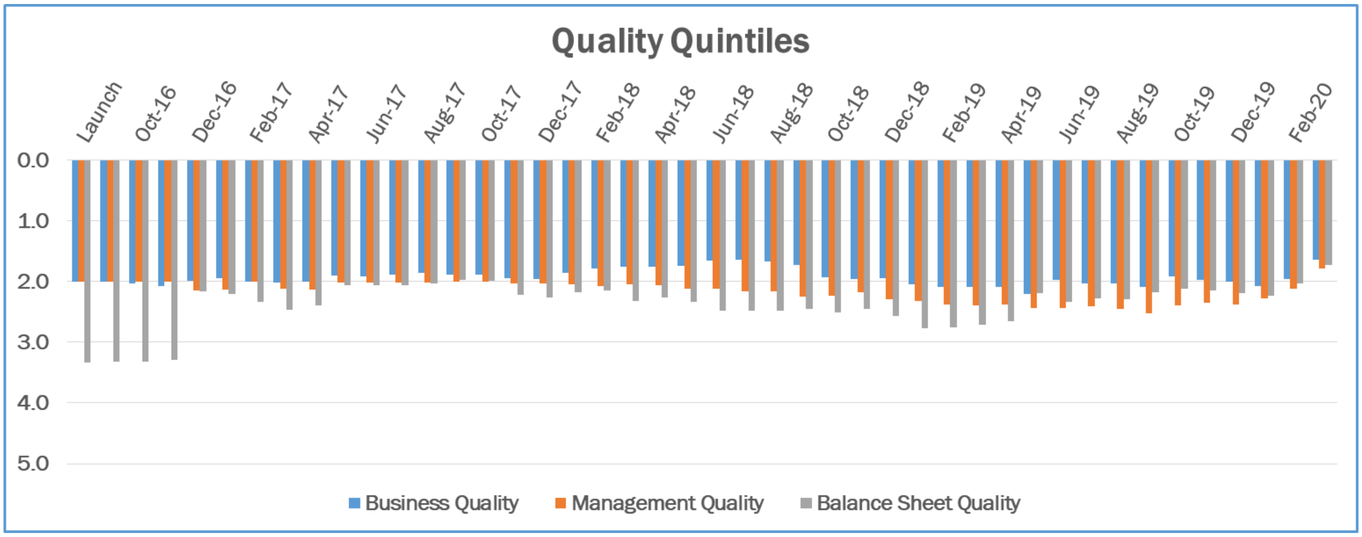
Price % Base Case Value

This metric tracks the portfolio's weighted average ratio between market price and my Base Case intrinsic value estimate of each security. This ratio is presented both including cash and equivalents, which are valued at a Price to Value of 100%, and excluding those. All else being equal, the lower these numbers are, the better. Excluding cash and equivalents, a level above 100% would be a red flag, indicating that the portfolio is trading above my estimate of intrinsic value. Levels between 90% and 100% I would characterize as a yellow flag, suggesting that the portfolio is very close to my estimate of value. Levels between 75% and 90% are lukewarm, while levels below 75% are attractive.



Quality Quintiles

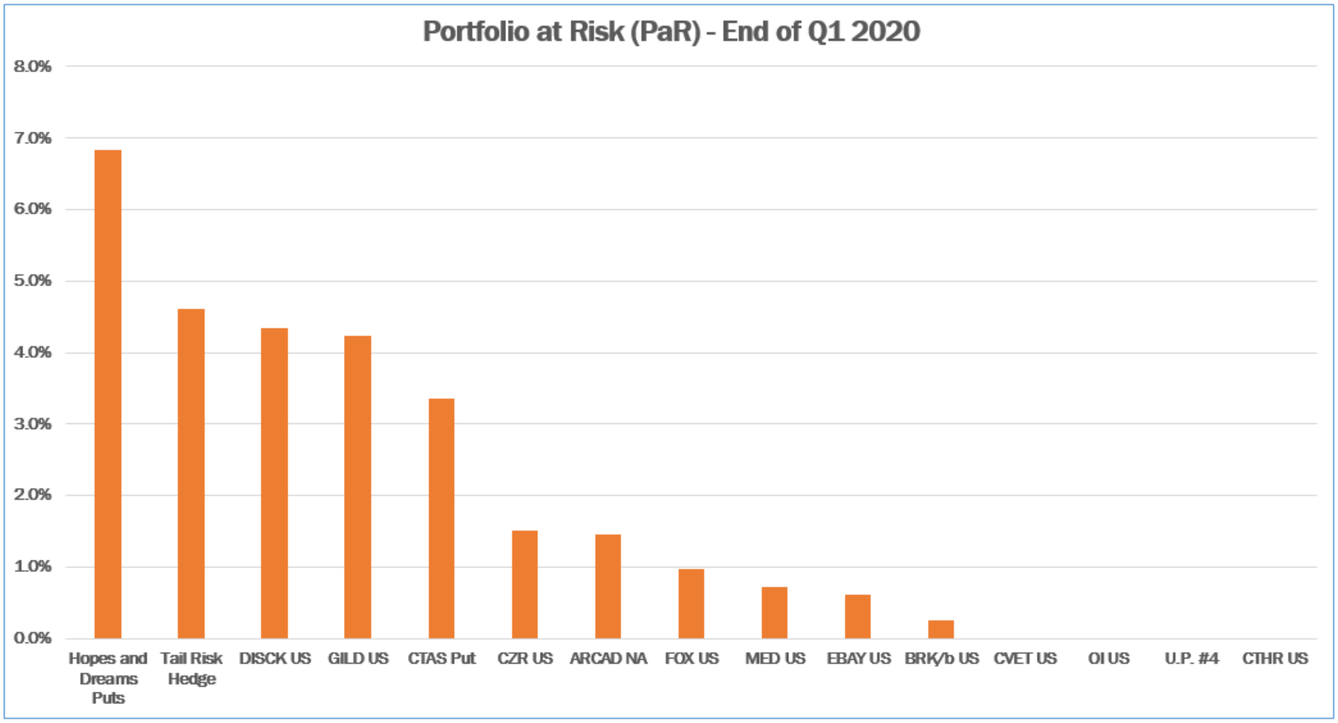
As outlined in the Owner's Manual, I evaluate the quality of the Business, the Management and the Balance Sheet as part of my assessment of each company. I grade each on a 5-point scale with 1 meaning Excellent, 2 Above Average, 3 Average, 4 Below Average and 5 Terrible. The chart that follows presents the weighted average for each of the three metrics for the securities in the portfolio.



Portfolio at Risk (PaR)

I estimate the Portfolio at Risk (PaR) of each position by multiplying the weight of each position in the portfolio by the percent downside from the current price to the Worst Case estimate of intrinsic value. This helps me manage the risk of permanent capital loss and size positions appropriately, so that no single security can cause such a material permanent capital loss that the rest of the portfolio, at reasonable rates of return, would not be able to overcome. I typically size positions at purchase to have PaR levels of 5% or lower, and a PaR value of 10% or more at any time would be a red flag. The chart below depicts the PaR values for the securities in the portfolio as of the end of the quarter.

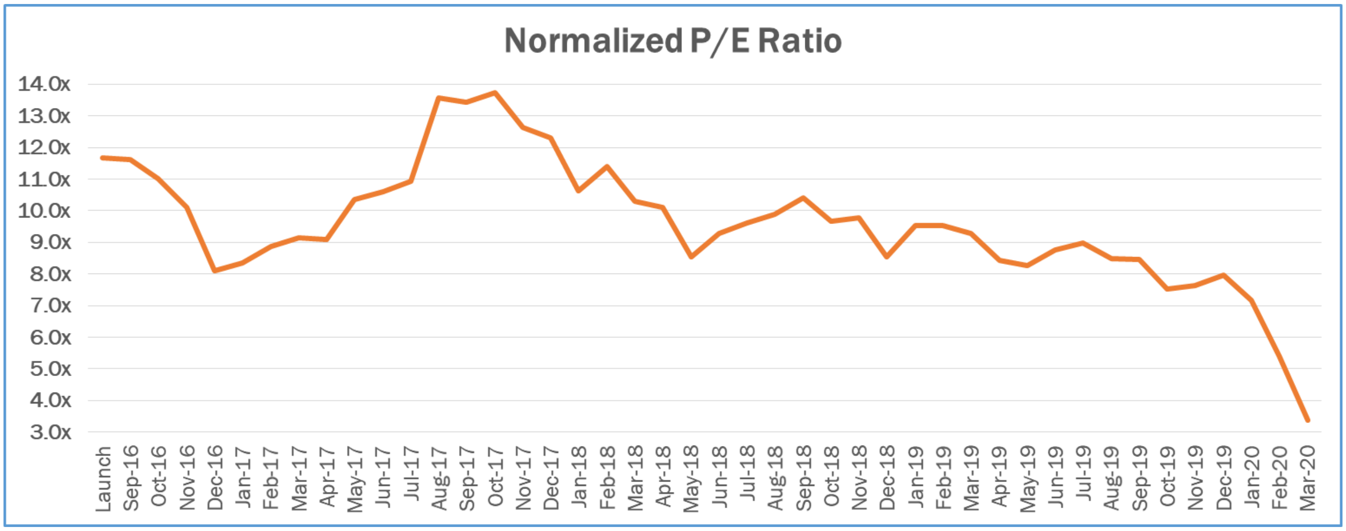
Note: Positions are presented including options when applicable. So for example, the Owens-Illinois position includes the impact of the hedge (put options).



Note: In cases where the Downside to Worst Case < 0%, PaR = 0%

Normalized Price-to-Earnings (P/E) Ratio

I supplement my intrinsic value estimates, which are based on Discounted Cash Flow (DCF) analysis, with a number of other metrics that I use to make sure that my value estimates make sense. One of the more useful ones is the Normalized P/E ratio. The denominator is my estimate of earnings over the next 12 months, adjusted for any one-time/unsustainable factors, and if necessary adjusted for the cyclical nature of the business to reflect a mid-cycle economic environment. The numerator is adjusted for any excess assets (e.g. excess cash) not used to generate my estimate of normalized earnings. One way to interpret this number is that its inverse represents the rate of return we would receive on our purchase price if earnings remained permanently flat. So a normalized P/E of 10x would be consistent with an expectation of a 10% return. While the future is uncertain, it is typically my goal to invest in businesses whose value is increasing over time. If I am correct in my analysis, our return should exceed the inverse of the normalized P/E ratio over a long period of time. The graph below represents the weighted average normalized P/E for the equities in the portfolio.


Normalized P/E Ratio
14.0x
13.0x
12.0x
11.0x
10.0x
9.0x
8.0x
7.0x
6.0x
5.0x
4.0x
3.0x
Launch
Sep-16
Oct-16
Nov-16
Dec-16
Jan-17
Feb-17
Mar-17
Apr-17
May-17
Jun-17
Jul-17
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Feb-20
Mar-20

Conclusion

After years of a frothy bull market, many investors might be tempted to jump in with both feet at the first sign of a cheap investment opportunity. That would be a mistake. Having invested for two decades and through two prior downturns (2001-2003 and 2008-2009) I have seen cheap stocks go from cheap, to cheaper, to very cheap… and then go down quite a bit more.

Conversely, being paralyzed by the barrage of news and not acting at all is a big mistake as well. Nobody can confidently call the exact bottom of any stock or the market and attempting to do so is folly. The best path forward is to *act deliberately, but slowly*. What this means is that as securities get more attractive, we should be committing proportionately more capital to them at a measured pace. If the price gets even more attractive, then we should add some more, all the while making sure that we are prepared for a scenario where the market and our securities experience a prolonged and severe decline.

Remember this: just because the pace of news and events is fast, doesn't mean that you have to act quickly. It is OK to do nothing, if there is nothing worth doing. Be patient. Take your time. But when it *is* time to act, do so decisively, on your own terms.

This environment brings to mind a scene from the movie *Braveheart*, whose character is played by Mel Gibson. The Scottish army meets the English on a field of battle, but lacks any heavy cavalry which the English possess in large numbers. The lightly-armed Scots risk being swept off the field by the charge of the English knights. Braveheart comes up with the only possible solution. He has his men make long wooden pikes, and hide them in a ditch in front of his line. For the ploy to work, the charging English cavalry cannot discover the pikes until it is too late. As the charging mass of cavalry approaches, Braveheart tells his men: “Steady!” The cavalry gets even closer. “Hooold!” The armored mass of men and horse is only a dozen meters away, and some of his men start reaching for the pikes. “Hooooold!!!” The horses are almost atop of the front line of Scots, and at that moment Braveheart yells: “Now!!!!”

I am happy to answer any questions you have. Your feedback is important to me; please let me know how I can improve future letters. I greatly appreciate your trust and support, and I continue to work diligently to invest our capital.

Sincerely,

Gary Mishuris, CFA
Managing Partner, Chief Investment Officer
Silver Ring Value Partners Limited Partnership

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