Koopman Partners LP 2023 Annual Report

January 4th, 2024

General Market:

The general market of 2023 was one of uncertainty with issues centered around recession fears, wars, increased interest rates and inflation. The Federal Reserve continued to raise rates, albeit at a slower rate than in 2022. The increased cost of borrowing money has an effect on both the consumer and corporation in an attempt to slow down the economy. The Fed is expected to begin reducing interest rates in 2024. Most of the gains in the market this year were led by optimism in artificial intelligence, good economic indicators and the Fed's reversal on interest rate increases.

While these are important to pay attention to as an investor, I tend to bury my head in the sand when it comes to general macroeconomic conditions. As we look through history, there has always been something to worry about when it comes to the global economic condition. If I were to let that worry consume me, I am fairly certain our results would suffer. My focus continues to be on individual companies trading at a significant discount to their intrinsic value- which I believe gives us the opportunity to do well in any market (See Berkshire Hathaway returns in the 1970's- a time of inflation, war, global uncertainty and high borrowing costs- sounds familiar?). Of course I have no crystal ball and have no idea where the markets could be headed over the next decade and I won't even attempt to predict it.

2023 Results:

In our first year of operations, we finished with a return of 24.43% from June 22nd (The fund commenced operations on June 22nd, 2023) through the end of the year. For full-year limited partners, assuming a pro-rated hurdle rate of 3.5% for the final 7 months of 2023, would result in a return of 19.20%. Partners who joined after the start date should expect to see different results. Including pre-fund operations for the first five months of the year, the return would have been 51.69%. In other words, outstanding results for our first year in operation. Please note that these figures have not been audited. For comparison are the major market indices over the time period from June 22nd, 2023 to end of year, including dividends:

1) S&P 500: ~10.29%
2) Dow Jones Industrial Average: ~12.05%
3) Nasdaq: ~11.62%

Year	Partnership Return	Limited Partner Return	S&P 500 Return	Differential from S&P 500
2023	+24.43%	+19.20%	+10.29%	+8.91%

The indices are not perfect but provide us with an important benchmark each year. It is my belief that these indices approximate the returns you would likely receive from most other funds, investment companies and registered investment advisors. My long-term goal is to deliver returns in excess of these popular indices whether or not the fund is plus or minus for the year. If I can't beat those over the long-term, there is no reason for this fund to exist.

Operations:

While we achieved superior returns in 2023, the strategy was largely hamstrung by a lack of available and incoming capital. There were a few opportunities that came up in mid to late October that I would have taken advantage of if the capital were available. I would venture to guess our results would have been better than what appears above had I taken advantage of the opportunities.

Buying and selling, was of course, minimum in 2023 with one company being sold and another different opportunity purchased. There were a couple of various trims or adds to existing positions as well.

The different opportunity in question is what's called a merger arbitrage. In this case, Company A is purchasing Company B for $27.25 per share. Usually in these deals, there is a spread between the trading/ticker price and Company A's purchase price. Company B was purchased by the fund at $22 per share. This would result in about a ~24% return should the merger go through early in 2024- exactly the deals I look for. Of course, the question is what happens if the merger fails. We would continue to own Company B for the long-term- as we should. My goal with any purchase or sale is either: a) heads we win, tails we win or b) heads we win, tails we don't lose much. I calculated the intrinsic value of Company B to be roughly $38 per share. Either way this deal goes, we stand an opportunity to make money with the latter being the better deal should the merger fail. A classic win-win situation I love to see and get the fund into.

Options sales in 2023 were at an all-time-low compared to pre-fund operations. During the period, the fund sold six option contracts with 4 of them expiring worthless. This results in a "win-rate" of 66.6%. A option sales "win" is considered to be an option that expires worthless or is bought back at a profit. As I have mentioned, our options sales are set up as a win-win situation where either outcome is beneficial for you as a partner. For puts, an option either expires worthless (we keep the premium) or we are obligated to buy shares we wanted to buy anyway at the agreed upon price. For calls, the option either expires worthless (we keep the premium) or we are obligated to sell shares we wanted to sell anyway at the agreed upon price. Put options are our preferred option to sell against cash on hand and can bring outsized premiums (15-50%+ annualized) in down markets. During pre-fund operations, my return in 2022 was kept in the positive largely due to aggressive option sales during times of heightened uncertainty.

A Case Study on Price-to-Earnings Ratios

A metric very important to our analysis of companies is the price-to-earnings (PE) ratio. It's not the end-all-be-all but a quick indicator of how expensive or cheap a stock is. Generally, the growth picture is priced into the PE ratio along with current earnings. Faster growing companies generally boast a higher PE ratio. But that doesn't mean we should pay that price for an all-too-often rosy growth picture. Many investors, myself included, have made the mistake of paying too much.

Here's an example of my own folly starting with an example dating back to pre-fund operations. In 2020, I purchased a wonderful company at around $80 per share with a PE ratio of 55. (55!) That means if I got to pocket all of the earnings, I would have gotten a 1.82% return that year. In 2021, the stock rose to a high of $141 per share with a PE ratio of 75 times earnings. It reached the price I wanted to sell at and the PE ratio was in the territory of insanity. However, in my greed, I still held the business. All sins are eventually punished, and the reckoning came in 2022 when the stock cratered to $41 per share resulting in a harrowing 71% decline! Of course, the prices in the $40's were quite an attractive deal for such a fast-growth company so I ended up purchasing more of the business at a PE of around 25- much more reasonable. This company was eventually transferred into the fund and sold completely in July and August for around $71.50 per share with a soaring PE of about 50 times earnings.

Here are the two outcomes of the different lots of shares purchased as a comparison:

1) The shares purchased at a PE of 55 and $80 resulted in a -10.6% return over 2 ½ years.
2) The shares purchased at a PE of 25 and $46 resulted in a +55% return in a single year.

The lesson to be learned here is that the price we pay for a business has a drastic effect on the returns we can expect to receive. Luckily, I made good on this investment and came out with a total return of 19.74%, including option sales. Eventually, time can help erase most mistakes.

This example is why I must insist on a margin of safety based on a conservative valuation when purchasing stocks. In this case, I was not conservative enough when valuing the company and plugged in a rosy growth rate based on the COVID-19 distorted market. Being conservative in the price we pay for a business can make the difference between outsized returns and negative/zero returns, as shown above.

Looking Forward

In early 2024, much like the back half of 2023, my main focus will be on raising the fund to a sustainable level and much less on searching for and analyzing deals for the fund to partake in. I like the current businesses we own and as of the writing of this report, have no excess cash to spend on new purchases. The fund is drawing a lot of interest from potential partners here in early 2024 so I would expect our available capital to increase drastically from 2023. My goal this year is to bring the fund up to full functionality where the fund can sell options and purchase companies when the opportunities present themselves, run audits on our books and hire employees/contractors to help me with the day-to-day books and partner onboarding tasks.

I have attached your statement of account, 2023 financials, final Schedule A, and a breakdown of equity percentages for the year. Please be on the lookout for 2023 tax documents. You should receive your Schedule K-1 form by March 15th.

I am looking forward to growing this fund and your wealth alongside my family. As I've mentioned before, all of my immediate family's net worth minus the house is in the fund. I eat my own cooking and have a vested interest in first growing your wealth.

If you have any questions about any of the matters above, please reach out. I will be happy to help you answer them.

Sincerely,

Sean Koopman

Disclaimers

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Cautionary Note Regarding Forward-Looking Statements:

Note: Some of the information above may contain forward-looking statements. Such statements include, in particular, statements about our plans, strategies and prospects. You can generally identify forward-looking statements by our use of forward-looking terminology such as “may”, “will”, expect”, “intend”, “anticipate”, “estimate”, “believe”, “continue”, or other similar words. Although we believe that our plans, intentions and expectations reflected in such forward-looking statements are reasonable, you should not rely upon our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. These forward-looking statements are subject to various risks and uncertainties, including, but not limited to, those discussed above under “Risk Factors”, that could cause our actual results to differ materially from those projected in any forward-looking statement we make. We do not anticipate to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Any of the above should not be considered investment advice. Please consult your financial advisor.