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Koopman Partners 2024 Quarter 2 Report

July 24th, 2024

The General Market

The S&P 500 broad market index produced a return of +3.92% during the second quarter of 2024. Gains in the general market were driven heavily by AI stocks and the hopes of Federal Reserve interest rate cuts. The general market during the second quarter of 2024 remains largely unchanged from the first quarter of 2024. Main issues driving the market are the Federal Reserve interest rates, AI and sticky inflation. I will add that the AI stocks (NVDA etc) will likely see a dramatic decline at some point in the next couple of years. History has taught us well: 2000's tech bubble, 2015 3-D printing stock bubble, 2020 electric car bubble (TSLA) to name a few. We'll continue to stay away from speculative ventures such as those. Here is what I said in the Quarter 1 letter that still stands:

> "*The S&P 500 produced a return of 10.16% in the first quarter of 2024. This return was largely held up by the hope that The Federal Reserve was going to pivot on interest rate hikes. Inflation has proven to be stickier than they expected with rates hovering above 3% year-on-year. It is my opinion that the Fed stopped increasing rates too early. They also should not have hinted at rate cuts so early. As we know, the market likes to price those cuts in early even though they still have yet to happen.*
>
> *It is also my opinion that we should not even be considering rate cuts. Interest rates have been artificially low for the better part of 15 years now. Borrowing money should have some friction. I view debt as a horrible drug- it feels good at the moment in being able to purchase the unearned and have it today. But over the long-term it causes great pain in business, government and personal finance.*
>
> *The corporate world has loaded up on cheap debt over the past 15 years. This lowers our pool of investable companies. It's always our philosophy that we want to buy businesses that we could hold for at least a decade. Heavy debt loads put businesses in jeopardy- of which we want nothing to do with. We aim for debt-to-free cash flow rates of less than 3. In other words, three years or less of free cash flow to pay off the existing debt. We also consider the cash on hand as part of this equation.*
>
> *The Fed will likely not be cutting rates this year. I believe they will likely increase them again to keep the flames of inflation at bay. I have no crystal ball. However, if The Fed continues to increase rates this year, it's likely we'll see a declining market in the back*

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half of 2024. In addition to uncertainty that troubles markets during a presidential election. I, of course, view this as an opportunity, should it happen.

Oil continues to be one of the biggest drivers of the inflation we are seeing. Oil is used heavily in everything we use everyday. Packaging, transportation, production and agriculture all use energy and oil products. These are a few examples of how a consumer product gets from the field/ground to your home and table.

We saw the same situation in the 1970's. Where inflation was persistent and oil was in short supply. As with any good or service: when oil is in short supply, prices go up. We know that oil drives our economy, as I mentioned above. Thus, prices of nearly everything will increase. In other words, this is the same persistent inflation we are seeing.

We continue to keep a close eye on the oil industry as inventories decrease and inflation remains elevated. Therefore, we view owning oil companies as a hedge against inflation.

Also of note: historically, inflation doesn't come in a single wave. There are usually multiple in the case of the 1940's/early 1950's (3 waves) and 1970's/early 1980's (2 waves). It is likely we will see another wave in addition to what we saw in 2022."

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2024Q1 Results:

During the second quarter of 2024, the fund produced an unaudited return of +10.56%. Net of fees, the return to limited partners would be +8.30%. During the same period, the S&P 500 (large cap) produced a return of +3.92% and the Russell 2000 (small cap) produced a return of +0.46%. For comparison to similar peer group funds, the HFRI ED Multi-Strategy Index produced a return of +1.08% for the second quarter of 2024. Our results delivered to limited partners far exceed that of any other commonly available vehicle you would expect to see. Of course, there is little reason to exist if we cannot exceed these benchmarks constantly over a 3+ year stretch of time. The table below shows our results by year compared to the benchmark indices:

Year	Partnership Return	Limited Partner Return	S&P 500 Return	Russell 2000 Return	HFRI ED MS Return
2023	+24.43%	+19.20%	+10.29%	+8.81%	+10.05%
2024Q1	+9.90%	+7.80%	+10.16%	+4.81%	+1.91%
2024Q2	+10.56%	+8.30%	+3.92%	-3.62%	+1.08%
2024H1	+21.51%	+16.88%	+14.48%	+1.02%	+3.01%
Cumulative	+51.53%	+40.18%	+25.07%	+9.92%	+13.58%
Compounded	+50.02%	+43.10%	+24.40%	+9.67%	+13.23%

Note: 2023 returns are from June 22nd, 2023 to year end.

To reiterate: 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 indices whether or not the fund is plus or minus for the year. If we can't beat those over the long-term, there is no reason for this fund to exist.

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Reiteration of our Advantages

There are many advantages in operating a small fund that I want to reiterate with all of you. We have three main advantages:

1. Where our opportunities are (<$15 billion market capitalization)
2. Our size and nimbleness
3. Our contrarian mindset

The first is that we can fish in different (smaller) ponds. The majority of passive investments are concentrated into the S&P 500. Another large constituent of fund managers in both mutual and hedge funds seek to mimic the performance of the S&P 500. In other words, the mega and large-cap end of the business spectrum is saturated. Saturated to the point where it is difficult to find a deal in those larger companies.

Our advantage continues to be found in the mid-caps and lower (<15 Billion market capitalization). These companies tend to hit the sweet spot in terms of growth and coverage. These businesses are excluded from the popular S&P 500 index. They are also not generally sought by the larger funds. The e number of investable companies decreases as a fund's size increases. Thus, we are able to look where relatively few others are looking.

Our size also gives us an advantage in buying and selling. We are more nimble and can buy and sell without influencing the price. That cannot be said of larger funds who must take weeks to sell out or buy into a position so they won't affect the price.

Our mindset, of course, is our largest advantage. When fear strikes, we stare that down with logic, evidence and reasoning in order to find wonderful deals. On the other hand, when greed takes over, we can sit and watch with patience knowing that deals will eventually come back our way. Essentially, if we do what everyone else does, we should expect similar results. To me, those results are average and I refuse to settle for mediocre.

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Operations

Operations during the second quarter of 2024 picked up. We completely sold out of Sprouts Farmers Market (SFM). While this is still a wonderful business, the valuations became too rich to justify holding on to. There were four purchases made from the proceeds of the sale that I view as better opportunities at this time. More opportunities have been available for the fund to purchase during the past quarter. Largely due to a decline in small caps and AI stocks (NVDA) driving most of the market gains this quarter and year.

Here are our holdings in no particular order or concentration:

1. **Albertsons Companies Inc (ACI)**

There is still a situation I mentioned within the 2023 Annual Report that I view as a great opportunity. The company in question is Albertsons Companies Inc (ACI)- a large national grocery chain. Kroger (KR), another large grocery chain, is purchasing ACI and merging as a new company: Kroger-Albertsons.

Albertsons ran into troubles in the early 2000’s and was purchased by a private equity firm. Over that time, operations of the business have improved- especially in the last 5-6 years. ACI went public again in June of 2020 with another Initial Public Offering (IPO). The share price has remained depressed since the IPO and even more so since the merger was announced.

On one side, the FTC and unions are fighting against the deal saying it will create less competition. On the other side, we must not forget about Wal-Mart, who has a stranglehold on the grocery market. Merging the two would create better competition between the two.

As I mentioned earlier this year, I argue there is still great value either way this deal goes. At the current share price, there is now a +37.5% upside should the merger go through. Otherwise, I believe the upside is likely a double if the deal fails. However, that’s certainly not guaranteed. We would also have more time invested should the deal fail.

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Excerpt from our 2023 Annual Report:

> "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."

Disposition: We added to this position during the second quarter of 2024.

2. **Lovesac (LOVE)**

I view Lovesac as another opportunity with great potential at the current trading price. This company is profitable, growing and securing more market share in a heavily fragmented and stagnant industry. This is likely a longer-term holding than our typical 6-36 months. Here's a high level overview within our 4 M's plus a catalyst/event framework:

Meaning: Lovesac is an innovator and producer of modular couches designed to last a lifetime. They also include many technology features within the couches. There is nothing on the market that comes close to what Lovesac offers.

Moat: The moat is developing. The company has many patents on their designs. There are trade secrets while they work to build their brand identity. Being from the middle class, almost everyone I know has a Lovesac couch on their dream purchase list. On top of this, couches can be shipped by major shippers for much cheaper than other brands. They can also be purchased piece by piece instead of all at once.

Management: Management has opted for small footprint stores leading to lower cost operations and higher margins. Founder Shawn Nelson is still with the company which is a positive. It's alway nice to have the founder still involved in the operations. The company maintains no debt and is adding at least a dozen showrooms every year.

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Margin of Safety: In my opinion, anything under $30 is a screaming buy for this company. I've purchased anywhere from $38 (old Margin of Safety-before update) all the way down to around $20 in 2022.

Catalyst/Event: There are two events/catalysts at play here: 1) the decline of retailers after all-time-highs in 2020 and 2021. The market largely over reacted to these businesses and priced them unbelievably low. 2) The furniture industry is heavily fragmented and LOVE continues to pick up market share while the sector remains flat.

Disposition: We reduced this holding during the second quarter to purchase other opportunities.

3. **Texas Pacific Land (TPL)**

I wrote in depth why we purchased TPL in: Inflection Year: How I Crushed the Market in 2021
As I mentioned above, we are continually monitoring the oil industry and have several more companies on our watchlist we would like to purchase in addition to TPL.

Disposition: No change

New Purchases:

4. **Five Below (FIVE)**

Meaning: Five Below is a specialty retail joint with a multitude of cheap goods tailored to children ages 8-15.
Moat: Five Below has a pricing moat. You can't buy most of these items for less anywhere else.
Management: Management has kept the company debt free and growing at >10% each year with a return on invested capital of ~20%!
Margin of Safety: Anything under $110 per share is viewed a good deal with adequate margin of safety
Catalyst/Event: Five Below continues to grow but could not meet Wall Street's lofty growth expectations over the last couple quarters. This resulted in a significant drop in price that doesn't make sense for an otherwise great business.

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5. **Howard Hughes Holdings (HHH)**

Howard Hughes Holdings is a real-estate business specialized in (MPCs) Master Planned Communities such as: Summerlin, Nevada and The Woodlands, Texas. The company operates four business segments: Operating Assets, MPC, Strategic Developments and Seaport. One of these businesses (Seaport) is not like the others. Seaport is an entertainment business with assets in Long Island, Las Vegas Aces AAA baseball team and others. This segment of the business is not profitable and is intended to be spun off in 2024.

If we only consider the three profitable real-estate segments of the business, it is currently trading at about a 14-cap rate or a 15 price-to-earnings ratio. If the spinoff is completed, it unlocks significant value for us as shareholders.

6. **Ruger Firearms (RGR)**

Meaning: Ruger Firearms is a leading manufacturer and supplier of recreational firearms in the United States.
Moat: Ruger Firearms maintains brand identity and pricing power moats.
Management: Management has kept the company debt free and maintains a return on invested capital of ~15-40% depending upon the business cycle. The dividend policy is sensible where a certain percentage of Operating Cash Flow is given to shareholders each quarter. When business is great, we should expect hefty dividends and special dividends.
Margin of Safety: Anything in the low $40 range represents a great margin of safety for Ruger. This range is a nearly 10-year cyclical low that Ruger has not dropped below since 2014.
Catalyst/Event: For some strange reason, firearms sales have not increased yet in 2024 with a presidential election on the horizon. It should be expected that sales will pick up in the 2nd half of 2024. Thus, Ruger stock should also increase.

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Looking Forward

Quarter 2 of 2024 represented a great opportunity for our fund with the volume of deals coming across the plate. I expect that many more opportunities may appear in the second half of 2024 as the presidential election nears and the AI frenzy calms. There are at least two to three more deals available now in addition to our four (ACI, HHH, RGR and FIVE) that I would like to add more capital to. Some of these may not last long so we'll have to act quickly for these to make an impact.

In quarter 2, we hired a marketing professional who focuses on writing. She is especially gifted with the ability to craft brand identities and stories. I'll be working with her over the next couple of months to create messaging and a framework for marketing efforts. The goal is to share our *highly differentiated* fund in a way that I have not been able to do on my own. I'm highly excited to see where this can take us.

I am looking forward to growing this fund and your wealth alongside my family and I. 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

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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.

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