

April 18, 2024

To Our Partners:

## Performance

### Owls Nest Partners Concentrated Long Only Composite through 12/31/2023

	4Q 2023	2023	3 Year	5 Year	Since Inception (7/1/2018)
Long Only (Net) <sup>1</sup>	22.43%	38.46%	11.33%	125.41%	95.27%
Russell 2000 TRI	14.03%	16.93%	6.82%	60.85%	32.95%
<i>Outperformance</i>	<i>840 bps</i>	<i>2,153 bps</i>	<i>451 bps</i>	<i>6,456 bps</i>	<i>6,232 bps</i>

## Holdings as of 12/31/2023

We ended the year of 2023 approximately 97.9% invested, owning the following holdings (in order of position size, largest to smallest):

Name	Ticker	Market Cap (\$ mm)	Sector	Industry
Xometry, Inc.	<b>XMTR</b>	1,626	Industrials	Trading Companies & Distributors
Progyny Inc.	<b>PGNY</b>	3,545	Healthcare	Managed Health Care
Goosehead Insurance Inc.	<b>GSHD</b>	2,758	Financials	Insurance Brokers
EPAM Systems, Inc.	<b>EPAM</b>	16,500	Technology	Information Technology Services
Ensign Group Inc.	<b>ENSG</b>	6,505	Healthcare	Health Care Facilities
Paylocity Holding Corp	<b>PCTY</b>	8,952	Industrials	Human Resources & Employment Services
Armstrong World Industries	<b>AWI</b>	4,253	Industrials	Building Products
Repay Holdings Corp	<b>RPAY</b>	837	Technology	Financial Transaction Processors
MarketAxess Holdings Inc.	<b>MKTX</b>	10,764	Financials	Financial Exchanges & Data
Tecnoglass Inc	<b>TGLS</b>	2,087	Industrials	Building Products
Interactive Brokers Group	<b>IBKR</b>	35,902	Financials	Investment Banking & Brokerage

**Median Net Debt/Market Cap:** negative 3.4%

**Median Market Cap:** \$4,253 million

**Active Share vs. Russell 2000:** 99.5%

<sup>1</sup> Past performance is not indicative of future results. Performance presented from inception through September 2020 is for a representative account of the Owls Nest Partners Concentrated Long Only SMA strategy (the "Strategy"). As of October 2020, performance is for a composite of accounts managed in accordance with the Strategy (the "Composite"). Please see the Disclosures at the end of this document for further information with regards to performance.

## Quarterly Attribution

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We start with the attribution for the fourth quarter, but the full year attribution below is a more interesting and meaningful story.

Perhaps Lord Macbeth was contemplating the short-term gyrations in his stock portfolio when he professed, “It is a tale told by an idiot, full of sound and fury, signifying nothing.” Last quarter we discussed Xometry in the context of it being our largest detractor year-to-date. This quarter it was our largest positive contributor. In the long run, not much actually changed along the way.

Although the clear leader in its space, Xometry is still in the first inning of the rollout out of its online marketplace for custom manufacturing. As such, results and stock performance can be volatile and lumpy in the short run. From our view, the long-term has only improved as they have added more capabilities and geographies to the marketplace and potential competitors have been casualties of the interest rate hike driven rationalization of startup funding. The Q3 results were solid and in-line with our expectations, but they were clearly better than what the bears/shorts had been preparing for.

Aside from Xometry, every other holding was positive in the quarter except for Interactive Brokers which was a very marginal detractor. Armstrong World Industries and Ensign Services were our second and third largest contributors.

## Portfolio Adjustments

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In an unusual burst of activity for us, we added three new holdings in the quarter: Paylocity, Tecnoglass, and MarketAxess. Adding three new names reflects our patience and nimbleness being rewarded. As we discuss below, all three fit our model of being industry leading, long-run compounders with great financial strength, currently facing a temporary headwind which coils future fundamental performance and adds kindling to the fire of future multiple growth as short-termers have temporarily fled the name until the dust settles and the reported numbers inflect positively.

We have followed these companies for some time, and we were able to move quickly once the stars aligned. Our ability to add three names is also indicative of some internal changes we made with our research process to make us much more efficient. The changes involve new systems, purging tasks that were of less value, and allocating more resources to new ideas. We are passionate about what we do, and we are always trying to get better.

To make room for the new holdings, we sold one position, Floor & Decor, and trimmed others.

The sale of FND merits discussion, especially since we have held it since the fourth quarter of 2018, and it is our second largest contributor since inception. The long-term thesis of owning FND remains firmly intact. There is plenty of growth left with their traditional stores, and the commercial business that they entered through an acquisition a few years ago has a full head of steam and is incremental to the original thesis. We continue to think highly of the management team. The current residential real estate headwinds are muting demand for them but crushing the weaker local independent retailers who still control the majority of the industry. Many local independents will be folding up their tents soon, ceding more share to Floor & Decor. And FND’s supply

chain is stronger and more resilient than ever, as is the quality of their real estate pipeline. Why then would we sell it now?

One of the strongest drivers of a solid sell discipline is the manager having real skin in the game, meaning the dermis and even some hypodermis in addition to all the epidermis. We have written and talked a lot about Floor & Decor over the last five years, and it's a great story to tell. If we were driven by marketing and asset gathering, we'd keep it. Who doesn't want to talk about the five-bagger in the portfolio? But we get paid for performance, and the bulk of our money is alongside our clients. As a result, we want every dollar to work as hard as prudently possible. Hence, we utilize what statisticians call a "forced curve". Simply stated, Floor & Decor's stock has moved up ahead of its current fundamentals to the point where a reasonable amount of good news is embedded in the stock price, and we think there is less risk and more upside potential in the other names we hold. It is entirely possible, even probable, that we will again own Floor & Decor, but it will have to make the portfolio stronger to earn its spot. Clearly, this decision to sell FND reflects our confidence in the new names and the amount of gas left in the tank of the other established holdings.

We also trimmed a number of positions, especially those whose stock performance made them (in the right way) a position sufficiently large that risk management mandated paring it back. The largest of the trims was Xometry as it bounced. We like where the proceeds were redeployed, and we're always fixated on risk even more than reward. After all, our money is beside yours.

## 2023 Attribution

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First, the simple part. You made money from every stock we owned in 2023.

Beneath the surface, 2023 attribution is an epic tale of the virtues of concentration and long-term orientation in practice. Our largest contributor in 2023 was Goosehead Insurance. If you need a refresher on our thoughts on Goosehead as we entered 2023, [click here for a link](#) to the 2 ½ pages we wrote on it in last year's year end letter. The point of discussing Goosehead in terms of last year's attribution is that we had the courage of our convictions in the second half of 2022 when others were mercilessly punting it and pushing it levels 80% lower than its 2021 high despite its growth in the interim. But because we had spoken with lots of carriers, competitors, current agents, and customers we were confident that Goosehead would over time be a huge winner. And because we only work for long-term oriented client/partners, we did not try to play what we believe is ultimately a loser's game of trying to anticipate short term movements in stocks. Instead, we confidently added more than 40% to our position in Q4 2022 as GSHD stock drifted lower. In 2023, Goosehead proved the haters wrong. Solid top line performance and exceptional margin performance drove very good financial results, and the stock responded. Despite the rally, a lot of gas remains in the GSHD tank. GSHD stock remains more than 60% off its 2021 high, and with a demonstrably better model and only 0.7% share in its industry we anticipate strong performance for Goosehead for years to come. We think the share gains and growth are secular, and the cyclical acceleration will kick in once the carriers, recovering from losses at the hands of the unanticipated recent bout of inflation, exit their current defensive posture in which they are pulling out of markets and reenter their growth mode which increasingly utilizes the very productive Goosehead distribution channel.

Our second largest contributor for the year was Xometry. How that came to be is again illustrative of ONP's structural advantages at work. Xometry entered the year as a 12.8% position, and it was up ~10% on the year.

Mathematically, XMTR would have produced ~1.3% of positive attribution on the year if we passively sat tight as the year unfurled. Instead, it produced more than 10.1% of positive attribution. As with GSHD above, we used what we call our “insight advantage” to adjust our position size and upsize it when the risk/reward was wildly asymmetrically in our favor. Some may speak of an “information advantage” in which they have some piece of knowledge they think gives them an edge. We think those are of questionable actionability in a stock market where everyone is looking for that little short-term nugget. Odds are someone else already has your nugget and probably the next one. An “insight advantage,” however, is rare, actionable, and only flows to those who can spend the time to put a full mosaic together and who can build the full view out to consider the long-term and how all the short-term noise fits into the long-term eventuality. It was painful at the time, but Xometry stock getting into the mid and even low teens was a great gift to us from the “short-termers”. We thank all of our clients for understanding our approach and allowing us to truly invest rather than play the loser’s game of “short-term info advantage”.

Our third largest contributor was Armstrong World Industries. What is most interesting about this fact is that we own Armstrong at all. We cannot find another actively managed portfolio in America that contains both Xometry and Armstrong. Ours is a portfolio that exudes contempt for style boxes. We go where we believe the greatest value is. To the man with a hammer, everything looks like a nail. To the man locked in a style box, everything inside that box looks like great value. We want to protect and grow capital, not be a leading performer in a dumb place to be. That said, someone did tell me the other day that small caps are at a historic discount to large caps. Hmmm.

We want compounders that have long, clear pathways of organic revenue and cash earnings growth. However, we don’t require any inflexible, arbitrary growth rate. Instead, we need a growth rate that is significantly greater than the rate embedded in the current stock price. And the growth needs to have a high degree of certainty, which is why there are whole swathes of the economy where we choose not to play. If we buy a pre-revenue biotech company, fire us immediately. In practice, this means that we have to concern ourselves with the whole range of possible outcomes, and it also means that we have to be able to run our full process of talking to suppliers, customers, distributors, ex-employees, competitors, etc. Armstrong is in no “growth manager” portfolios, but it will grow earnings at a much greater rate and with a much higher degree of certainty than the rate embedded in the price. It has spent a lot of time on investor’s exile island (who wants to own anything that is perceived as tied to office buildings, all of which are going to be foreclosed upon and torn down?), but people may be waking up to the fact that the vast majority of the business is repair and remodel as opposed to new construction, that only 30% of the business is tied to offices (in which they include data centers which are growing like a weed), and that new products have important innovation features like the ability to dramatically reduce HVAC loads, and all those price increases the last six quarters are finally flowing through while the costs of manufacturing are headed south as natural gas which peaked in August 2022 above \$9 (USD/MMBtu) now hovers around \$3.

Lastly, our fourth largest contributor for the year was Floor & Decor, going out in style. Thank you for your service.

## Impact of Higher Interest Rates on our Portfolio

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Conventional wisdom suggests that smaller companies need financing, and hence smaller-cap equities should be sold in any sort of rising or 'higher for longer' interest rate environment. This belief no doubt contributes to the current record discount of small stock valuations versus their large cap brethren. However, like most broadly accepted and easily applied truisms, there are plenty of exceptions. Take our portfolio, for example. Our companies in the aggregate have net cash (cash less any interest-bearing debt) to market cap of 12.6%. Our average company has cash equal to over 750% of its debt. These companies can easily fund their own growth and have plenty of financial firepower available to them in case any unique opportunities present themselves.

So, what has been the impact of higher interest rates on our companies? To some extent, it's like a person who bought a house a few years ago, who didn't need a mortgage but took one out anyway because a 2.7%, 30-year fixed-rate mortgage seemed like a good source of funds. How have rising rates affected that homeowner? With money market funds yielding 5%, the homeowner is actually profiting on the deal. Likewise, our companies are simply making more money on their excess cash. What's wrong with that? But other knock-on effects are even more valuable. The price of any acquisitions they have contemplated as a use of that excess cash has fallen significantly. Rising rates have rationalized the competitive environment as marginal projects get scuttled, and the VC funding collapse inspired by rising rates has effectively wiped out a generation of potential future competitors. Collectively the impact is that our companies will be able to more fully exploit their competitive moats for years to come. So, while all this good stuff goes on, we can buy shares of the cash-laden smaller companies at steep discounts. Remind me, please, why I am supposed to hate higher interest rates.

## Why Are We So Lucky? The Guide to New Idea Entry Points

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Here we will introduce you to your three new holdings and use them to highlight our thinking and process around new entry timing.

Before a company becomes a viable candidate for our portfolio, we must satisfy ourselves that it is that rare company that has durable and expanding competitive advantages, thrills its customers, has a long runway of self-financed growth, and an aligned management team that can allocate capital as well as it can manage a business (two very different skill sets). If a company can pass that high bar, then the question becomes "what else needs to fall into place before the company can earn a spot in the portfolio?" The answer is nuanced and complex, but its essence can be captured in answering the following questions:

*Is the entry point fully de-risked from a vantage point that defines risk as the possibility of permanent capital loss?*

*How can this company make our portfolio better, and is there enough "juice in the squeeze"?*

*Are expectations, both those that are published and those that are embedded in the current stock price, unreasonably pessimistic in the intermediate and long term?*

*Why and when are the company's shares going to rerate higher, and who is that incremental buyer?*

And, perhaps most importantly, *Why are we so lucky?*

If you cannot answer that one and know who is on the other side of the trade and why, then you are simply playing musical chairs and not investing.

To introduce our three new holdings and to illustrate this thinking around entry points, we answer these questions on each name.

### Tecnoglass Inc (TGLS)

Tecnoglass is a fully vertically integrated manufacturer of architectural glass for multifamily housing and commercial construction and high-end windows for single family residences. Tecnoglass's ES Windows unit is gobbling up share in its large and fragmented industries because its complete vertical integration and low-priced labor at its manufacturing facility in Colombia drive lower costs, superior quality, faster product innovation, and shorter lead times. The buildout of the enormous manufacturing footprint stressed the balance sheet making it a challenge for us to buy prior to the last year or two. However, the company will soon have zero net debt and is generating tons of free cash flow since it is now on the back end of the most aggressive expansion investments. The successful rollout of single-family residence windows starting in 2019 has greatly reduced business risk by giving the company a growing foundation of more stable repair and replacement business and also improving cash flow since the new products have shorter lead times compared to large projects. At the same time, the rapid adoption of their single-family products has greatly expanded their upside potential due to the huge size of the market and their growing but still very small share.

Tecnoglass is now the statistically cheapest name in the portfolio, and most of our stock was bought at only 6x 2024 EBITDA despite double-digit growth and a clear path to improved margins. It sells at an enormous discount to its peers despite superior economics. In fact, companies that have its financial profile typically sell at more than double the multiple TGLS does. A fluke in Q3 provided us with a great entry point. Although headquartered in Miami and having 96% of its business in the United States, all of the company's manufacturing is strategically located in Colombia. As such, essentially all its labor costs are denominated in the Colombian Peso which also acts as its functional currency. In Q3, the Colombian Peso soared 25% against the US Dollar which hurt margins and led to a nearly 500 basis point non-cash accounting driven hit to margins as it had to mark up the value of its inventory which it had already paid for. The company is not widely followed, and shareholders punted driving the price to levels which implied that this was a shrinking business with permanent margin impairment, which is the opposite of the reality. The impact of the currency volatility is waning, and the shares will move higher on the back of accelerating profit growth later this year. In addition, the stock is not in any index and barely owned by any ETFs. With the formal move of the HQ to Miami from Colombia, the company has now become eligible to be entered into relevant indexes the next time those indexes are reshuffled.

We believe we understand why others sold this. Q3's reported numbers disappointed meaningfully. It may have been the result primarily of a surprising and unprecedented and unlikely to be repeated movement in the currency markets, and one that the company can hedge against in the future if it chooses to, but nonetheless it is a fact that a smaller, less liquid company with little institutional sponsorship took numbers down in an environment that was jittery to begin with. That leads to dislocation. The sellers aren't stupid, but they must concern themselves with short-term momentum and can't justify the heavy fundamental work needed on such a small position and are instead left to extrapolate from recent data points. But we have been to the factory in the Colombia ([here's a link to a video – the 0:20 and 2:30 mark provide a sense of the sheer scale of operations](#)),

and we have talked to dozens of glass and window distributors, specifiers, and installers. We've even bought the product. We have the ability to look past this mostly currency and accounting driven reduction in numbers and can confidently buy this stock because we have a model which allows us to do all the work needed to understand and ultimately benefit from the very significant underlying strength of the business and the multiple expansion as the company becomes better followed.

### Paylocity Holding Corp (PCTY)

Paylocity is a leader in human capital management (HCM) software, a beautiful business with a massive addressable market given that every business globally requires payroll services. HCM software companies enjoy a highly resilient, predictable stream of recurring revenue protected by generally high switching costs and pricing power. High barriers to entry are created by a required knowledge base of over 11,000 taxing jurisdictions and local labor laws within an ever increasing and increasingly complex regulatory and compliance environment. HCM companies benefit mightily from the growth of their clients which drives the compounding nature of the business. Client employee growth means more employees serviced and the need for additional HR modules as complexity and compliance needs grow. And the largely fixed cost nature of the business amplifies these benefits providing significant operating leverage.

Paylocity offers a unified, modern cloud-based payroll and HCM solution, catering to businesses with up to 5,000 employees. Payroll and HR software is a critical business system that is also non-core and hence logically outsourced. Integration with other key business applications and tax and regulatory compliance make it highly sticky and predictable. Paylocity thrills customers with its product-led approach. In an industry where many players sell offerings cobbled together by acquisition, Paylocity offers an elegant, unified home-grown approach which is evidenced by their leading R&D investment as a percentage of revenues.

Insiders collectively own nearly 23% of outstanding shares. This alignment supports the company's long-term strategy for value creation through strong product and efficient marketing and even in its bottom 10% share dilution among a comp group of over 115 technology companies. With a current customer base of 36,000, Paylocity holds less than 3% market share in terms of the number of businesses in the U.S. There is an unquestionably long runway to continue growing client count double digits, picking off pieces of the 100,000 – 200,000 customers that churn off legacy competitors, ADP and Paychex annually. Additionally, there is an opportunity to take share from the 60% of the market still controlled by regional software providers, regional CPA firms, and in-house solutions lacking the technological capabilities and nuances of local tax/labor expertise across the country to scale with companies as they grow. Combine this steady client growth with a track record of expanding their product suite to better address customer needs, while also benefiting from landing larger accounts and expanding within existing ones, and you have a market leader with an enviable growth model.

We have closely tracked the company since 2017. In that time, it has traded at a median and average forward P/E of roughly 60x. This premium was justified because of its durable growth, margin, and cash flow profile. Today, the company is the cheapest it has ever been on a multiple basis. It has historically traded at noticeable premium to the relevant group of enterprise SaaS (Software as a Service) peers, but today it trades at a 25% discount. For an absolute return investor like us, it has historically traded at prices that required tailwinds and near perfect execution, but today it trades at prices that can only be justified by almost never-ending headwinds sloppy execution by a team that has rarely missed. Why has this once-loved darling of Wall Street been thrown

away? Many investors managing broadly diversified portfolios incorporate elements of thematic and momentum investing into their process, and currently, investors of that kind are averse to exposure to sectors tied to employment and benefitted by higher interest rates. Paylocity grows as their clients add employees, so the business has a meaningful correlation to non-farm payrolls. With many employers reconsidering what in hindsight appears to be reckless hiring during COVID, Paylocity and its peers indeed face real but modest pressure on near-term fundamentals. But the market been extrapolated well beyond the current reality and has completely forgotten that this is an industry that grew revenues and earnings through the global financial crisis and that Paylocity is a company that grew meaningfully during the greatest headwind to employment in generations – COVID.

Irony is always present in the stock market. In the real economy, if your competitor did something stupid and annoyed a lot of his customers and exposed the fact that he had been overcharging for a long time, you would be very happy. In the stock market, if that happened your stock would take a hit alongside your competitor because people would be scared that you would be next somehow. This dynamic helped create our entry point when a similarly sized competitor announced surprisingly bad earnings and guidance because the forced rollout of a process in which employees approve their own payroll annoyed some customers and revealed that the company had effectively benefitted from payroll errors in the past by charging for every rerunning of payroll. Customers of that competitor are angry and looking to change providers, and one former employee there described the situation there to us as a dumpster fire. Our work confirms the competitor's problems are self-inflicted and company specific and will actually benefit Paylocity in the marketplace. But for the time being that company's woes have depressed Paylocity's stock as well, deepening the value available at this entry point.

Today's price assumes a permanent decline in the market share growth, need for additional modules in their client roster and hiring growth almost never returning. Nothing we hear from clients suggests any of those. At some point in the not too distant future, hiring trends will stop getting worse and even improve, and then those on the sideline will seek the quality of Paylocity. We have this opportunity only because we are willing to look past the current headwind because all the clients and partners of Paylocity we have talked to have made it clear that Paylocity's position remains strong, and the industry remains the source of great compounding growth. Temporary pullbacks on staff counts will always be a risk for a company in this industry. However, adding Paylocity today is a classic example of buying when the risk is exposed and dominates the discussion as opposed to when the risk is forgotten in a period of self-satisfied glee when all cylinders are firing.

### **MarketAxess Holdings Inc. (MKTX)**

MarketAxess is spearheading the digital transformation of fixed-income trading with a multi-sided platform aimed at delivering greater trading efficiency, a diversified pool of liquidity, and significant cost savings to clients across the global fixed-income markets. Holding a 20% share of high-grade credit trading volume and a 50% share of high-grade electronic trading volume, MarketAxess occupies an enviable position with the most robust dataset on traded bonds in the market. This data advantage, coupled with network effects from having over 2,000 institutional investors and 140 dealer firms across 80 countries, enables MarketAxess to provide trading clients with superior liquidity, enhanced execution levels, and improved decision-making capabilities across a wide range of fixed-income securities.

The electrification of fixed-income trading represents a secular growth opportunity. Most equity trading on exchange is done electronically via a central limit order book (CLOB), where market participants can declare their trading intentions, and others can accept or reject the offered prices and sizes. Fixed income is a different animal. There are over 66,000 U.S. corporate bond CUSIPs compared to approximately 4,500 U.S. listed equities. This makes maintaining a CLOB for all bonds a challenging task, as the vast number of securities leads to many bonds going for extended periods without trading. As a result, the fixed income market has developed into a meaningfully different market structure, historically heavily reliant on manual trading with large dealers (i.e., banks). Today, 60% of institutional fixed income trading is conducted through inefficient manual phone-based trading or Bloomberg chatting with a dealer. Like many other sectors of the broader economy, fixed-income trading is on an inexorable march towards digitization, with an avalanche of near-term regulatory changes and technological advances, most importantly trading algorithms, coming to severely shake up the existing market structure.

The growth algorithm for MarketAxess is a combination of market volume growth, MarketAxess's share of the market, and the fee per million (FPM) they earn on trading volume. The Fed tightening cycle has depressed all three components of the growth algorithm, only increasing the cyclical headwind the industry is already facing. Higher interest rates have depressed FPMs, an inverted yield curve and uncertainty on the direction and magnitude of future moves in rates has led to investors shortening duration which further depresses FPMs, and retail investors have pulled out of fixed-income after the second worst market ever for 60/40 portfolios in 2022, further limiting secondary market trading volumes that are already down due to low volatility and the narrowest credit spreads since the late 1990s.

MarketAxess is not immune to these pressures as their revenue growth has fallen from consistent double-digit results to flat, and with a high fixed cost expense structure, margins have fallen over 1,700 bps from recent highs. Investors who have historically piled into MarketAxess because of its track-record of share gains in an over \$100 trillion industry have sold fearing the good times are over as reported market share has stagnated and have extrapolated recent performance leading to embedded expectations implying margins not recovering for the next decade. But this is another example of investing when the risks are exposed and dominating the discussion, concurrently creating a terrific entry point for us.

As with any investment cycle, no one can predict precisely when investors will feel comfortable extending duration, or when volatility will increase, and sidelined cash will flow back into bonds for higher income and potential price appreciation. However, the nature of cycles is that you make money when the worst-case scenario has already played out. Additionally, the company has invested heavily over the last three years in a new trading platform whose rollout has just gotten underway. Our conversations with early adopters confirm great interest in the powerful new features which will drive share gains. Further, we have spoken to enough large participants in the credit market to verify that the market will continue its inexorable shift to electronic trading at the expense of old-fashioned manual trading benefitting MarketAxess. And while the credit markets churn and stabilize and eventually revert toward historic patterns, the company will continue to maintain best-in-class liquidity in credit and deliver operating margins north of 40% and ample cash flow to invest in new offerings, accelerating share gains on top of market driven reacceleration once the market turns leading to a significant re-rating on top of rapidly improving fundamentals.

## Changes to the Team

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If you are reading this section of the letter, it is because you have a keen eye and know the risks associated with personnel changes. Hopefully, you don't personally bear the scars associated with a manager scaling and then secretly spending all of his time and attention on his vineyards, race cars, society pages, plans to save the world (or at least his vision of how the world should be), etc. while leaving the shop in the hands of the lesser and untrained apprentice. Or worse yet, trying to run the show entirely while on the red carpet at the event held at his vineyard in the south of France while making sure all the various divas are happy.

So, I am happy to say there were no changes to the makeup of our team in 2023. But there has been one "promotion", at least in title. Sam Gudeon is now officially Co-Portfolio Manager for all ONP accounts and funds. Since joining Owls Nest on January 2, 2017, Sam has worked incredibly closely with me as I tried to replicate the old school "partners desks" that I had with my first boss. Sam long ago evolved from talented worker bee analyst to essential partner in all decision making. Our success over the last seven years, especially last year, is due in large part not only to his effort but also to his judgment. I think it will become clear in the long run that the best investment I have made is the time I have spent with Sam passing on, while also contemplating and revisiting, all that I have learned over decades on the front line as a PM.

Sam is months away from being the same age I was when I was first officially a PM. I know the yearning to have your name on the track record that anyone as competitive as Sam or I feels. To his credit, Sam has not asked for this promotion. He is humble and feels, like any investor should at any age, that he still has much to learn. Sam is certainly better prepared than I was when I became a full-time PM, and my results turned out surprisingly well.

Beyond the title change, nothing changes. Except for one small thing. Sam and the team of analysts have hit a great stride, as has our firm. And it is my duty as the steward of our business as well as our collective capital, to keep Sam and the team intact without distraction. The title change is part of that. The other change is to finally stop taking advantage of these people's passion for our unique mission and to start paying them what they truly merit. So, the research team has deservedly received significant pay increases, and we have installed a new bonus structure tied to outperformance.

Our commitment to investing with passion and without distraction requires us to reconsider our fee structure. Management fee revenue is a function of AUM multiplied by management fee. Unlike other shops, we eschew scale. We reiterate this commitment to capacity constraint, even as we get nearer and nearer to the \$500M AUM level at which we will close. This leaves us with only the management fee as a means of coping with increased costs. Accordingly, if we have any available capacity as of January 1, 2025, we will need to raise our management fees modestly to 1.25% for all NEW clients. We are not seeking to change anything for our existing clients, reflecting our gratitude for your help in building our business.

## Investment Program

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For the benefit of any first-time readers, the hallmark of the Owls Nest Partners approach is the purchase of industry leading growth companies when a temporary headwind has recoiled the fundamental growth drivers and compressed its multiple. This typically happens as hot money "renters" exit and drive the price down. There

is no such thing as a free lunch: we can only receive our requisite value if we accept that our companies will appear “catalyst-less” and uninteresting for some time. We believe we are wildly overcompensated for this modest level of patience, especially since it is in these moments that a company can invest in its own business with the highest returns. There is wonderful optionality associated with a well-run, shareholder friendly, cash-laden company that is able to aggressively put money to work during a temporary headwind.

It is our belief (and experience) that our future outperformance will not be driven by any economic or market forecasting prowess but instead by ten unique investments, each playing out over time. We perceive these investments to have modest downside due to high quality and low expectations, and very significant upside as growth and margin expansion return in spades. We seek reasonable ballast and diversification within the portfolio as a result of our natural conservatism (strengthened by our co-investment alongside clients) and our predisposition to avoid crowded trades and instead invest in temporarily out of favor areas.

### **Final Thoughts**

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More than ever, we thank you for your support and for choosing to have your money working alongside ours.

Gratefully,

Philip, and the Owls Nest Partners team

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**DISCLOSURES**

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