Mutoro Group Partners, LP

Third Quarter 2017 Letter

November 7, 2017

"Be entrepreneurial about your education." – Ta-Nehisi Coates

Dear Partner,

When I began studying the art of investing nine years ago, I think I was fortunate to bring a healthy sense of humility to this inherently self-confident act. I had never invested before, and above all, I wanted to avoid losing money. While I had heard many suggestions for how to do it, most were conflicting or impractical, so it was initially very unclear what to do. It turns out, there was a profitable liberty in acknowledging my crudeness. Untethered to bad ideas, which are incredibly difficult to shed, I was free to learn the good ones. Reading every book and article I could, it became clear that to invest well over an extended period demanded constant learning and deepening degrees of understanding. I was excited for the challenge.

With the financial crisis of the Great Recession underway, the emotional extremes the world was going through heightened my appreciation for the rigor of the field. Once vaunted figures and institutions toppled in ways few had foreseen, and even fewer had acted upon, despite legions of professionals having the same access to see it. The lesson there was to stay centered enough to decrease your chances of getting swept thoughtlessly into group opinions and sentiments. Otherwise, you're essentially hoping for luck to play a larger role in your results than skill. While the blanket of success either weaves is worth sleeping under, I think you find greater warmth focusing on what you alone can influence. As an investor, I have tried to do that, staying patient, independent-minded, and concentrated on what I can control; areas such as the composition of the portfolio, the companies I investigate, and the patience I bring to buying and selling. To be clear, what I cannot control, such as the level of the markets, the short attention span of the news cycle, or a sudden volatility in our holdings, I do not simply ignore. Instead, I try to acknowledge and manage their influence through a practiced equanimity.

To do something well that so many people are attempting, you not only have to work at it consistently and stay composed, you also have to operate differently. This was true for all my investment heroes. Though retellings of their stories often paint as inevitable what was actually never preordained, when you dig into the details of their work, you see just how different they are from the masses. One idea seemed to connect them all, showing up repeatedly in anything I read that actually made sense: Price is what you pay for an asset, and the value of the asset is what you estimate you will get in return; price and value are often similar, but when price deviates far from value, opportunity arises. That was hardly all there was to learn, but it was the bedrock upon which you could build all other useful inferences on how to invest. It is a simple and powerful idea; but, like how to lose weight, stick to a budget, or avoid a hangover, simple advice does not mean easy compliance.

I think about these guiding principles always, and especially this year, as the markets have run to new heights, and the prices of the businesses we own have fluctuated much more than their value. Price is usually a given in the public markets; you can quickly find the levels at which the marginal buyer and seller are willing to exchange their ownership stakes. But we should never underestimate how dramatically those levels can waver. Take our portfolio for

example. The median difference between the latest 52-week highs and lows for the equities we have purchased is 83 per cent. While I think our businesses are competitively well positioned, I doubt their value changed that much over the last year. And this directly relates to why our fund is down 8.34 per cent for the first nine months of 2017 after being up 19.19 per cent for all of 2016. We have a lot of cash, which is not without short-run risks. The table below shows our portfolio at quarter end. (We added a position in a Company F, which is the U.S.-based leader in a large, consolidated industry with high regulatory and economic barriers to entry and scale.)

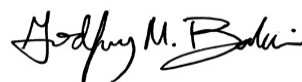
Cash and Cash Equivalents	67.8%
U.S. Public Equities	23.6%
Foreign Public Equities	8.6%
Total Portfolio	100.0%

Portfolio concentration and a lot of cash means that as the prices of our non-cash assets fluctuate greatly, even if their values do not, our total headline results do as well.

Perhaps to appreciate this better, let us look at one holding briefly: Company B, which I described in this letter last year as one of the global leaders in a small, oligopolistic software market. Before we became owners, sales were up 30 per cent and free cash flow margins were in the mid-teens. Yet its shares fell more than a third after management barely missed its revenue guidance. However, the company's revenues were still growing attractively, and it had no financial leverage, had instituted a large share repurchase program, had a founder-CEO acquiring more shares with his personal capital, and still had a robust business model. "Moreover," I wrote, "its principal competitor was on the ropes, restrained because of too much debt." Thinking that Company B was priced well below its worth, I acquired shares. After our purchase, its price rose 97 per cent. I then wrote that I would "evaluate selling in the near-term as it is approaching the top of the range I estimated for its intrinsic value." Spoiler alert: I did not sell. While the price was beginning to exceed my estimate of value, I did not think it so above the long-term growth of the business that I should sell. The price subsequently fell 31 per cent through the second quarter of 2017. Had its value declined? Looking at the evidence, I did not think so; the company financially and competitively appears stronger today than it was when we first bought it, and its future brighter. So, I added to our position. It then fell another 24 per cent through the end of the third quarter. While I think its value has not changed, this fall in price contributed meaningfully to our lower results. The universal lesson here, which I have repeatedly seen these nine years, is do not presume you are buying bottom prices (or selling top ones). Moreover, a change in price does not imply a change in value.

Thank you for your partnership in the Fund. I value your thoughtful patience immensely through periods such as this when our temporary results do not reflect the value of our portfolio or the long-term likelihood of our success. I remain deeply excited about the challenge of investing, and I look forward to the days when our patience is again rewarded. Should you have any questions, please do not hesitate to reach out to me via phone or email.

Sincerely,



Godfrey M. Bakuli
Managing Partner