PRAETORIAN CAPITAL

April 28, 2019

TO THE INVESTORS OF PRAETORIAN CAPITAL FUND:

Q1 marks our first quarter together. PCF was up 4.88% net of expenses and incentive allocations, despite only being partly invested for much of the quarter.

As this is our fund's first quarter, I thought it would be useful to speak a bit about the goals of this fund before going through a few of our largest positions. To start with, this fund will be invested differently than many other funds that seek to mimic or exceed a static benchmark. PCF has no benchmark and is an absolute performance vehicle meant to produce returns in up and down markets. By using a concentrated portfolio approach, my goal is to produce strong absolute performance over rolling 3-year periods, as 3 years should be a sufficient timeframe to ascertain if an investment decision was correctly underwritten. That said, since the fund will be concentrated in only a handful of positions, the fund is highly likely to experience erratic performance over shorter periods of time.

Similarly, I am un-focused on short term swings in the portfolio, as such swings tend to be arbitrary. Instead, my reporting to you will primarily be focused on realized gains and losses as only realized positions show if decisions were correctly underwritten. With all of this in mind, one quarter is rather irrelevant to overall returns—though I am happy to report that our first quarter was a positive one. The performance was largely the result of realized gains in a number of short-term event-driven positions offset by a roughly break-even performance from our existing investments.

My goal in constructing our portfolio is to have two types of positions:

> We will focus on a handful of longer-term un-correlated positions, that will provide the ballast to our performance—though returns will be quite erratic on a monthly or even annual basis. These positions will be selected based on two primary situations that offer outsized returns; undervalued smaller growth companies that are undiscovered by the market and larger market-cap securities that have fallen disproportionately yet are now at an inflection point in their businesses and will potentially reverse their prior share price declines. In general, we are looking for companies that can increase many times in value under anticipated circumstances and we will rarely be looking at companies that are merely undervalued based on discounts to current industry or market valuations. This is because you need sizable winners to offset the inevitable losers. Finally, balance sheet strength and valuation will be key factors in limiting our downside on any position if things do not play out as anticipated.
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> The quarterly returns of this concentrated grouping of equity investments will then be smoothed out by a number of tactical, event-driven situations, which tend to be recurring in nature, with a positive expected-return profile. As many of these event driven situations involve selling puts on undervalued securities, we will frequently earn our premium and either have the options expire worthless, or get assigned equity positions with a small gain or loss. These equity positions can then either become longs or get discarded and new puts can be written to earn premiums in the future.

While it is somewhat un-orthodox to own such a concentrated portfolio, it seems silly to diversify beyond our best ideas, simply for the goal of smoothing short-term returns.

Turning to the portfolio, our 5 largest positions starting from largest, were STNG, TSLA (put spreads and puts), SD, AR, ASPS. Below is a brief summary of each position in order of size.

Scorpio Tankers (STNG – USA) is the world's largest product tanker operator. Its fleet is entirely comprised of new eco-tankers and all but the smallest vessels will be receiving exhaust scrubbers that comply with IMO 2020. IMO 2020 states that all ships must either burn low-sulfur fuel or install scrubbers. This will likely lead to an increase in demand for low sulfur fuel transport at a time when the supply of product tankers is already somewhat tight as new deliveries trail off over the next 2 years. This increase in demand for product tankers should lead to an increase in charter rates. For every $1,000 increase in daily charter rates, the company will earn an additional $45 million compared to a roughly $900 million market cap where we purchased our shares. Into late 2019 and beyond, I believe there is the potential for rates to spike by tens of thousands, especially early in the IMO 2020 implementation period as various existing trade routes are disrupted and demand increases.

Shipping has historically been a terrible place to invest; however, there are often brief periods where these businesses earn truly extraordinary returns—often due to government-mandated changes to existing trade routes. IMO 2020 is such a change and I am expecting that charter rates will respond. As always, the concern is what happens if I am wrong. In this case, we've purchased our shares at roughly half of NAV and the company has been roughly cash flow neutral even at historic low charter rates (at least they aren't destroying too much capital). This whole investment is predicated on a dramatic increase in charter rates in 2020. If this does not happen, I intend to exit the position. If rates spike, the shares should as well.

(Put Spread Position) Tesla (TSLA – USA) is almost certainly a Ponzi Scheme where Musk continuously unveils new products, in order to issue equity capital and garner customer deposits for products that will never be produced (as they often haven't even been designed yet). As with most Ponzi Schemes, the underlying business mainly focuses on incinerating capital and laundering the remainder to a host of related parties—of course, this is all based on analyzing publicly-issued financials that are highly dubious. The question is; when the will the scheme end?

Fortunately, a few millennia of financial history tell us that when more money goes out than comes in, Ponzi Schemes collapse. Despite having the EV field to itself, Tesla has never earned a sustainable profit and what little profit it has publicly reported, has mostly depended on accounting machinations that are akin to fraud. As competing EV models come to market, I expect losses to accelerate. At the same time, Tesla hasn't raised new equity capital in over two years; meanwhile rapidly declining sales numbers and a host of regulatory issues may preclude future capital raises—leading to an imminent business collapse.

Finally, it has emerged that Tesla vehicles have serious design flaws that lead to wheels falling off. These design flaws have led to hundreds of vehicular accidents—many of which have been quite serious; including over a dozen fatalities. As additional evidence of this design flaw and Tesla's complicity in hiding the flaw emerge, I believe that it will become the target of regulatory action and class action lawsuits. Americans may let the golden-boy of EVs skate by with securities fraud, but killing a few dozen people a year is likely to prove beyond the realm of acceptable—even to the most fervent believers in Musk's schemes.

Tesla is entering a period where demand for their vehicles declines and financial losses accelerate, yet Tesla's stated balance sheet is ghastly, while almost certainly misstating the true state of affairs (which is even worse than it looks). Finally, there are multiple exogenous events that may precipitate a share-price collapse at any time—particularly if any regulator (globally) decides to do their job and protect the lives of their constituents by forcing a product recall. In my two decades in the financial markets, I have not seen such an obvious stock promotion scheme where the business is facing multiple existential crises simultaneously—without any reaction from the share-price. When a recognition of the obvious does come, I expect the share-price decline to be swift and violent.

I have chosen to express this position through long-dated put spreads and puts as the timing of Tesla's collapse is uncertain and I can minimize our risk in the event of a short squeeze by using defined risk instruments. That said, barring a massive capital raise, Tesla will go bankrupt in the near future—that much is certain.

Sandridge Energy (SD – USA) is a producer of natural gas that trades at less than 2 times enterprise value to EBITDA, despite currently-depressed natural gas prices. Additionally, the company has no debt while the corporate headquarters is likely worth approximately half of the current enterprise value. Stripping out the corporate HQ, the shares trade for about 1 times enterprise value to EBITDA. These metrics make it one of the cheapest energy companies in my universe.

The company is using its cash flow to drill holes in Colorado at an oil asset that has repeatedly exceeded expectations. While I am not a fan of drilling holes when a stock is this cheap (they should be buying back shares), Carl Icahn is the largest shareholder and he controls the board. Icahn is one of the smartest financial operators over the past century and I feel confident that he will find a way to extract the obvious value here, by proving up the Colorado asset and then selling off the pieces. Oil prices have increased since we acquired the position, hence the value of the assets have also increased—which should aid Icahn in his sale efforts. In the interim, Q1 natural gas prices were hedged and higher oil prices should lead to increased cash flow—showing how cheap the underlying assets are.

Antero Resources (AR – USA) is a producer of natural gas and NGLs. AR owns 31% of Antero Midstream, which is worth roughly the current market cap; hence you get all of AR's upstream assets for "free" (though there is debt offsetting a portion of this value). The upstream assets will produce substantial cash flow at current commodity prices, which will be used to de-lever and invest in growth to fill pipeline commitments. Once the pipeline commitments have been filled, the growth rate will slow and cash flow will be used for buybacks and de-leveraging. Whenever you get something for "free" as you do with AR, and the underlying stub entity is creating value, it's usually smart to own some—especially if management owns a LOT of stock and is incentivized to find a solution to create value.

In terms of natural gas, I am bullish on the sector as the price has been suppressed due to byproduct production from primary shale oil producers. As shale oil production growth slows due to poor financial returns, (lack of tier 1 drill location, parent-child interference and a host of other issues) I believe that gas prices will rally—particularly as gas demand continues to grow for the next few years due to both domestic and export demand growth. At gas prices in the $3's, both Antero and Sandridge should experience substantial increases in cash flow. Meanwhile, they each have strong balance sheets with substantial cash flow at current commodity prices.

Altisource Portfolio Solutions (ASPS – USA) is a service provider to the mortgage industry, specializing in solutions for non-performing loans (NPLs). The business has suffered over the past decade as the number of US NPLs has declined, leading to lower revenues and cash flow for Altisource. That said, I believe that we are at an inflection point as property prices have stalled out nationally. As property prices are well beyond sustainable levels in terms of price to disposable income, any slow-down in price appreciation should stress owners—particularly if property prices decline as I suspect that they will. Altisource trades at about 5 times (cyclical low) cash flow (pro-forma their VC investments in Pointillist and Owners.com). I suspect that during the next year, they'll find a way to get both of these funded using someone else's capital, which should unlock the true value of these businesses. More importantly, the profitability of the core business has been hidden by continuing losses from their VC businesses, hence, removing this burn should make the value of the core business more obvious. Incidentally, this core business will inflect if NPLs increase. Meanwhile, the company continues to focus on using cash flow to repay debt and buy back shares—which should be accretive when the business does inflect. I am rather bearish on housing prices and I cannot think of a better way to reflect this view.

Returning to the fund itself, our investment exposure is lower than I would normally expect it to be. My goal is to continue to increase the number of longer-term asymmetric positions, where the upside is a few times the current share-price and the downside is somewhat constrained by the current valuation. However, I continue to fail at finding attractive investment opportunities at valuations that are acceptable to me. The sectors that are cheapest, are all in commodities and I want to avoid an over-concentration in one sector. Outside of commodities, most companies trade at valuations that have no historical precedent in terms of overvaluation. Until we see some sort of pullback in the market or individual sectors, I expect the fund to maintain a reduced exposure profile, which will weigh on our performance as cash earns sub-par returns. That said, I have a long list of companies that I hope to purchase on any pullback in the market.

I remain focused on finding additional opportunities and will update you again at the end of the second quarter.

Sincerely,

Harris Kupperman