PRAETORIAN CAPITAL

Q1 2020 Investor Letter **May 4, 2020**

TO THE INVESTORS OF PRAETORIAN CAPITAL FUND;

During the first quarter of 2020 the fund declined by 41.22% net of fees. Given our concentrated portfolio structure and focus on asymmetric opportunities, my expectation is that during most quarters, the fund will be up or down roughly 10%—followed by quarters where one or more positions move dramatically and impact overall returns. During the first quarter, all expectations went out the window, as pretty much everything we owned collapsed in value. In my experience, when the overall market has a moderate pullback, the smaller asymmetric opportunities that this fund owns tend to get hit harder. When the overall market has one of the sharpest declines in the historical record, you should expect that this fund will underperform dramatically. During the first quarter, it didn't matter if a company was doing well or poorly, if the shares traded above or below book value, nothing mattered as everything was sold. As our companies tend to be less liquid, they were sold more aggressively—despite fundamentals that are dramatically stronger than the broader market. As proof of that, as I write to you today, the fund has reversed most of the decline from Q1 and was even up on the year for a brief moment in late April.

Drilling down into the substantial movers during the quarter, we gave back fourth quarter gains of roughly 11% of the fund's capital on Stage Stores (SSI – USA) when we booked the position in January. Despite the decline in the position's value from the end of December until January when we exited the position, we actually had a small overall gain on SSI during the time that we held the position, showing that when you underwrite something well, even if you get it wrong, you shouldn't lose money. In this case, I got the thesis quite wrong and still snuck out with a small gain. Additionally, we realized an approximate 11% loss of our capital on Altisource (ASPS – USA) during the quarter (more later). These two realized positions accounted for more than half of the total losses experienced by the fund during the quarter. In addition to these realized losses, we experienced mark-to-market losses on pretty much every other core position as the market collapsed—offset by gains in the event-driven book.

It has become something of a cliché in investor letters to bemoan; indexation, quantitative strategies, algorithms, government interventions, the Federal Reserve and the market's stupidity in not comprehending value. I agree; these are all valid bogeymen that you should blame for my underperformance this quarter—in fact, I request that you blame them. Otherwise, feel free to blame amorphous demons like; random volatility, cross-owner margin calls, arbitrary liquidations and general market incompetence. In summary, blame someone or anyone but me. I showed up, bought cheap stocks with strong tailwinds, took a pounding and until proven otherwise, the first quarter's decline just ain't my fault.

OK; everything in this fund is my fault. We had a terrible quarter. I saw COVID-19 coming, I was more fearful than most. We liquidated one of our core positions before COVID-19 hit, we reduced a few other positions early in January, we purchased shares of a mask maker that roared, we had a substantial stake in a company tied to life settlements during a pandemic (this one actually doubled; though it should have done better), we were long shares of tankers who benefit from a buildup of oil storage (surprisingly these collapsed despite charter rates going to all-time highs). We were positioned correctly, but we still lost money—a lot of money. It is my fault because we are not supposed to lose

too much money in any one quarter and 41.22% is a bit more than I would normally expect to lose—especially as we cycled the portfolio to benefit from this pandemic. Ironically, a few weeks further on, we recovered most of the losses as there was nothing wrong with our portfolio. Rather, the problem was the shareholder base that also owned our positions. They panic sold our securities for no logical reason.

In summary, we had a bad quarter, worse than I would have expected, but the losses are already fading into the rear-view mirror. It was an aberration that will likely occur again and again. Unlike many funds, I actually hope this happens more often, giving us an opportunity to accumulate discounted shares in our core positions, while our event-driven strategies often thrive in this sort of environment.

On Volatility…

Most investors bemoan and hide from volatility—I thrive on it. You see, from time to time, this manic lunatic named Mr. Market takes the wrong cocktail of crazy pills and Quant Easing, arbitrarily dumping shares at silly prices. Sometimes, you wake up in the morning and sort of shake your head because you wonder why Mr. Market is handing you almost risk-free money. As a long-term opportunistic investor, volatility and drama are my friends. The lower prices go, the less risky an investment becomes. If I can overlay that with a positive macro-economic backdrop in a sector, I have a homerun on my hands. I tend to not be fully invested for long periods of time, because I know that these moments of market insanity are brief, sudden, and incredibly lucrative. The bargains that we picked up will power our performance for quite some time to come.

On Tankers…

During the first quarter, as we all sat at home hiding from germs, I mulled the impact that 20 to 30 million barrels per day of excess oil supply would have on tanker earnings. If supply builds up, eventually you overwhelm land storage and are forced to store oil on tankers. As the first quarter progressed, tanker rates rallied and then went parabolic. In fact, rates hit all time historic highs at the same time that tanker equities hit multi-year lows. I tend to be one of those antiquated investors who believes that cash flow ultimately drives share prices. As a result, during the first quarter, we used the insane volatility in share prices to dramatically increase our ownership of various tanker equities. Putting this all into perspective, shares of Scorpio Tankers (STNG – USA), one of our largest positions at the start of the year, declined from $39 to $12 during the quarter. This is despite the charter rate for a Long Range (LR2) increasing to all time high rates. Today, rates are roughly $175,000 per day and at today's rates, Scorpio will have cash flow of approximately $1 billion each quarter, or roughly the current market cap (please note that such extreme rates are not sustainable). You can use similar math on many other vessel types. As you can imagine, we took advantage of this to dramatically increase already overweight positions in tankers.

These positions needed to be funded somehow and we sold our positions in;

-Uranium Participation (U – CN) for a small loss and right before the price jumped dramatically as a number of large uranium mines were shut in due to COVID. Given that I think uranium can potentially double while my tankers could increase by many times that figure, the risk of missing the move in uranium seemed worthwhile.

-Altisource Portfolio Solutions (ASPS – USA) had previously been our largest position and our sale hit the fund for a 11% loss during the first quarter. Normally, a pandemic where no one pays their mortgage would be the sort of thing that sends Altisource parabolic. Instead, the government changed

the rules on the company and it isn't clear how defaults will be managed and if homeowners even need to pay their mortgage. Ultimately, I'd like to get back into this stock, but I want more clarity on the rules and how they also impact Ocwen (OCN – USA) who is their largest client. Right now, the current rule changes have seriously wounded Ocwen, potentially fatally. Until the dust settles, I prefer to watch and observe. I guess you could say that I should have been more attuned to the risk that the government socializes homeowner losses and the bull thesis could never actually play out. I always knew this was a possibility, but I underweighted the likelihood of it happening, to our detriment.

-Turquoise Hill (TRQ – USA) owns 67% of a copper mine in Mongolia, a country I am unusually familiar with. I despise mining, but I'm fortunate that I have an unusually large number of on-the-ground contacts in Mongolia. During the fourth quarter of 2019, they alerted me to the fact that the cost overruns which had plagued the mine and collapsed the share price were abating and the company would likely be able to live within the most recent budget, which would reduce the need for an equity raise and dramatically re-rate the shares. As COVID-19 hit, my sources in Mongolia informed me that the mine was experiencing issues with importing materials and that their copper exports were being halted. We exited the position just in time as the shares collapsed a few days later. We ended up earning approximately 46% during a few-month holding period on a medium sized position, though we sold for less than the 2019 year-end value.

Position Review (top 5 positions at quarter end)

Tanker Basket (DHT – USA, EURN – USA, FRO – USA, INSW – USA, STNG – USA, TNK – USA)

Going forward, rather than comment on individual tanker companies, I will focus on the sector as a whole, as we recently diversified the position further over the course of the first quarter.

I have been baffled at why tanker stocks have not performed better since we purchased them. The repeated refrain is that current rates are unsustainable. I agree with this view. Rates in the top 5% of historic rates over the past decade are likely to mean revert. That said, I think they revert to a much higher plateau than after prior spikes as the fleet continues to age and the forward order book is at the lowest level it has been at in years. IMO2020 serves as a gating function and every geopolitical event or in this case COVID-19, serves to spike rates higher.

Tanker bull markets end when they order more vessels. Even if someone orders a tanker today, it will be almost two years until it is delivered. During this two-year window, the tanker companies that we own can easily earn many times their current market caps as rates are likely to remain elevated. In the interim, with debt rapidly being paid down, the next step is capital returns to shareholders in the form of dividends and buybacks that hopefully should re-rate the valuations of these companies.

I remain of the belief that a profitable company that more than earns its cost of capital is at least worth its Net Asset Value (NAV). After applying first half cash flows, I believe that most of our positions trade for less than half of NAV and potentially as little as a quarter of NAV. As I believe that the oil glut from COVID-19 will lead to higher earnings for the next few years, I would think that a premium to NAV is more than warranted. That means that many of these tanker stocks could appreciate substantially from here and still appear cheap. While we wait, NAV is rapidly building due to all-time high charter rates, which serves to further de-risk the investment.

Dorian LPG (LPG -USA)

Dorian owns Very Large Gas Carrier (VLGC) ships. These VLGCs carry propane. At current charter rates, the company will earn roughly $1 - $2 per share in cash flow each quarter, which isn't too bad for a stock which was trading at $8 at quarter end. Book value is in the low $20s per share and the company will be using most of this cash flow on buybacks at less than half of book. As you can imagine, this is wildly accretive to shareholders.

While Dorian often trades with a high correlation to our tanker basket, I actually see this as a natural hedge to our clean tanker position. You see, when naphtha prices increase, propane is substituted and propane demand spikes, which is great for Dorian, though less good for our clean tanker owners. When crude oil prices decline (like we are currently witnessing) naphtha demand spikes at the expense of propane and clean charter rates go into the stratosphere. In summary, as demand swings back and forth, Dorian ought to hedge out our clean tanker exposure while being unusually cheap in its own right.

Emergent Capital (EMGC—USA)

Emergent owns 27.5% of a portfolio of life settlement policies with an average age of 85. As you can imagine, a pandemic with high mortality amongst those over 80 years old, ought to be beneficial for Emergent. As news of the pandemic spread, the shares spiked and it was one of our only winners this quarter. As the policies "mature" over the next few years, I anticipate that the shares will be worth north of a dollar, compared to our cost basis per share of $0.19. That said, if the portfolio sees an increase in maturities due to COVID-19, then future premium payments would be reduced and there's a not small chance that the shares are worth a few dollars.

This was always meant to be a few percent position in the portfolio as there never was a catalyst beyond the passage of time. Oddly, as the share price doubled on the pandemic while the rest of the portfolio sunk, this emerged into the top-5 list. I anticipate it will sink away into obscurity in our portfolio as the rest of our positions recover.

Two Anonymous Positions

We have been actively purchasing shares of two companies with substantial property holdings, trading at discounts to those property values. Both positions were hit due to their hospitality businesses which shuttered due to COVID-19. These positions both made it to the top-5 list and I'd prefer that they remain anonymous for now.

In summary, the first quarter was volatile and we experienced unusually large mark-to-market losses that do not in any way reflect my perceived value of our holdings. To prove this point, as forced liquidations ended and investors sought out bargains, at one point during late April, we were actually up on the year. I expect continued volatility over the next few months as investors react to every new COVID-19 data point—including moments of sheer panic on a few occasions. We have minimal margin exposure and have sold calls against some positions to take advantage of this volatility. I don't think

anyone knows how this all plays out as we are in uncharted territory, but I know that I'd rather have less exposure so that we can react as the news comes at us.

I feel strongly that we are well positioned for whatever may come during the remainder of 2020 and I believe that it will be an unusually good year for us as our sizable tanker positions will finally be rewarded.

Sincerely,

Harris Kupperman
Chief Investment Officer

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