PRAETORIAN CAPITAL

Q4 2020 Investor Letter January 26, 2021

TO THE INVESTORS OF PRAETORIAN CAPITAL FUND;

During the fourth quarter of 2020, the fund appreciated by 93.94% 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 fourth quarter, our core portfolio appreciated dramatically with almost every position showing substantial gains; this followed an elongated period where many of these positions were a drag on our returns. The performance was further augmented by substantial gains in our Event-Driven Book, which has continued to surprise in terms of consistency and magnitude of performance results.

Praetorian Capital Fund LLC		
	Gross Return	**Net Return***
Q4 2020	113.25%	93.94%
2020	159.39%	127.51%
2019	18.27%	14.97%
Since Inception	206.78%	161.57%

*Unaudited net return data is estimated, net of all fees and expenses (using the expense structure in place at the time)

It goes without saying that quarters like we just experienced are rare and unlikely to be repeated in the near term. If anything, after an unusually large quarter, I would expect some consolidation in our positions and the potential for a pull-back, leading to somewhat subdued forward performance. As always, my expectation remains that the vast majority of this partnership's returns will be truncated into short periods of time, followed by periods where not much happens for us.

During the second quarter, I mentioned how our Event-Driven Book suddenly experienced strong performance for the first time since this fund's inception. This performance has continued, despite declining overall market volatility during the third and fourth quarters. As a reminder, the goal of Event-Driven trading is to utilize our excess capital to capture unique and discrete events that are short-term in nature (ranging from a few days to a few months), liquid, actionable, and recurring. The key is that no one position should matter much to our overall performance—particularly on the downside. Instead, we should experience gradual gains as a result of correctly analyzing these events and the opportunities that they create.

As noted in the third quarter letter, I reduced our Event-Driven positions dramatically in October and kept our exposure subdued into early January. This unfortunately resulted in us missing out on substantial additional upside—particularly as the fourth quarter was one of the best periods for Event-Driven since I started monitoring these strategies two decades ago. When Event-Driven is working, it is REALLY working. We are in the process of re-building our exposure and are hopeful that the set-ups continue to arrive and produce solid returns, and we are now utilizing full positions as opposed to the scaled down sizing we used during the fourth quarter.

The Correct Framework

During 2019, I was fixated on a pending global recession caused by a slow-down in Central Bank money printing along with global trade wars. As a result, I ran the portfolio with reduced exposure, some shorts, some put spreads and a concentration in the sorts of companies that do well when the economy is weak. As a result, our returns in 2019 were depressing—although we did produce a 14.97% net return to partners while taking on reduced risk. In the end, the recession that I expected was interrupted by the arrival of COVID and a dramatically changed economic backdrop.

In reaction to COVID, Central Bankers set their printing presses on "ludicrous mode" while global governments crossed the Rubicon on the fiscal side. While many businesses are suffering from COVID, asset prices have zoomed ahead of anything rational. I was early in recognizing what was happening and positioned our portfolio for asset inflation. As a result, this partnership had a very strong year.

The performance difference between the two years is material, and it comes down to correctly recognizing where we are and where we are going. In 2019, I set our portfolio for a crash that never came. We didn't lose money, but we didn't perform anywhere near as well as I would have hoped to. Starting in March of 2020, I set our portfolio for "Project Zimbabwe," which is my term for what happens when governments go rogue (money printing, fiscal insanity, bad policy mistakes, over-regulation, etc.). By having the correct framework and having a good sense of history, I had a hunch as to where we were going and also a strategy to play it (long inflation assets, dramatically increased gross long exposure and a big Event-Driven book). While there will be moments of extreme volatility along the way, we remain firmly in the "Project Zimbabwe" framework, especially with the Democratic Party in control of the Presidency and Congress.

One of the great advantages of this partnership over many others is that the mandate is so broad. We'll go wherever I perceive the opportunity to be. While my preferred environment is one where small-cap growth companies can be acquired cheaply, that is not the world we live in today. Instead most asset prices are overinflated, particularly those showing solid growth. Meanwhile, undervalued companies tend to cluster in sectors with considerable earnings volatility and questions about their futures. In particular, cheap assets today are mostly in cyclical and commodity businesses. While I've never cared if the earnings are volatile or smooth, as long as the shares are cheap, I do not wish to have the fund overly concentrated in commodities—particularly as they tend to move in unison with extreme volatility. Besides, there may be better opportunities out there.

Ever since March of 2020, there has been a massive influx of retail day-traders (many periods of monetary instability have witnessed similar periods of retail exuberance). The majority of these traders are unsophisticated in finance and tend to gravitate towards momentum and frauds (often at the same time). If these new traders are intent on collectively losing hundreds of billions of their dollars to the professionals, we'd be foolish not to participate in this great money transfer. Hence, our balance sheet is increasingly exposed to various Event-Driven opportunities as opposed to the value stocks that I would have expected to be purchasing when I first launched this partnership.

Given the massive number of day-traders overpaying for call options, dealers have dramatically increased implied volatility on puts as well (they use puts to lay off risk). Currently, implied volatility levels are frequently many times what they would have been on similar stocks before COVID. It's gotten so absurd that you can frequently get paid a few percent a month to write $10 strike puts on SPACs that have yet to close their transactions. Contemplate that statement a bit—retail is so mesmerized by buying overpriced calls that dealers are forced to lay off risk by paying you a few percent a month to insure their T-Bills. It's absurd and a good chunk of it is effectively risk free due to the redemption feature of the SPAC. Oddly, 3% a month of risk-free performance is dilutive to other strategies with slightly more

elevated risk profiles that we are targeting. With puts this overpriced and the consistency of decay so assured, it makes little sense to do much else with our capital—especially as "Project Zimbabwe" likely cleaves off a good chunk of our downside tail risk.

I know that this period will eventually end, likely in tears; but until then, I intend to capitalize on it—with the knowledge that when it does end, we'll likely have a pretty nasty drawdown in the Event-Driven book. This fund is unique in that it seeks out the sort of volatility that others cannot accept. Conceptually, I see no harm in a strategy that produces a string of big months followed by a pullback where we give back a third of the gains. Since we're currently having big months, it's worth reminding you of this. It won't always be this good.

At the same time, please do not think I'm getting carried away on the Event-Driven side. Roughly 80% of our capital remains invested in our core book, primarily in money printing and domestic volatility beneficiaries. Eventually, the framework will change and we'll pivot to where the new opportunities are. By identifying "Project Zimbabwe" and studying it intensely, I believe I have the right framework for today. I am amazingly proud that this partnership was up 127.51% net during 2020 when I got the framework correct, however I'm even more proud that when I got it wrong in 2019, we were still up 14.97% net.

Position Review (top 5 positions at quarter end)

Grayscale Bitcoin Trust (GBTC – USA)

Bitcoin is many things to many people. To me, it's an elaborate Ponzi scheme. As of today, GBTC owns approximately 647,000 Bitcoins or roughly 10% of the total free float of roughly 6 to 8 million Bitcoin. Further restricting the float, MicroStrategy (MSTR – USA) owns roughly 70,784 coins. A few months back, I began building an elaborate spreadsheet to track all the other entities who continue to acquire coins and will likely never sell them—either because the entities are designed to only purchase coins or because of the negative publicity associated with selling. I came to realize it was a fool's errand to try to tabulate it all. There are simply too many entities and they all continue to buy. Meanwhile, there are certainly many large corporations and individuals that are quietly purchasing or considering purchasing coins.

As the float restricts, it takes less incremental capital to move the price higher. During the fourth quarter, this theory of mine began to become a reality, and I suspect that price increases continue in future quarters—especially as the magnitude of buying is rather stunning. While I know that Bitcoin is fundamentally worthless, I suspect that it goes much higher over the next few years as it thrives on my core macro thesis of inflation, volatility, and chaos.

Normally, I'd avoid investing our capital into a Ponzi scheme—albeit a highly liquid one. However, by using the "Project Zimbabwe" framework, I almost wonder how I could not participate in the first truly globally-distributed Ponzi scheme. With that noted, I want to mention that I remain fixated on when to sell. Bitcoin is worthless and there's a long way down once it tops out. I am not religious about our bitcoin exposure and I intend to be a seller at some date in the future, likely well before the top.

St. Joe (JOE – USA)

While Bitcoin is functionally worthless, JOE is the most undervalued large company on the US stock exchanges. Together, these two positions make an up a unique and oversized duopoly in our portfolio.

JOE owns approximately 175,000 acres in the Florida Panhandle. I see no plausible way to come up with a net asset value per share that is less than $100 and many models come out much higher. It has been widely known that JOE traded for a tiny fraction of fair value for years, but without a catalyst, it was always perceived to be “dead money.”

Over the past few years, the population of the Panhandle has hit a critical mass where the Panhandle now has a center of gravity that is attracting people who want to live in one of the prettiest places in the country, with zero state income taxes and few of the problems of large cities.

The oddity of the current disdain for so-called “value investments” is that many of them are actually growing quite fast. I see JOE growing revenue at 30% to 50% each year for the foreseeable future, with earnings growing at a much faster clip. Meanwhile, the shares trade at a high single-digit multiple on AFFO looking out to 2024, while you get over $100 per share in asset value tossed in for free.

Besides the valuation, growth, and high ROIC of the business, why else do I like it? For starters, land appreciates rapidly during periods of high inflation—particularly an inflationary period where interest rates are suppressed by the Federal Reserve. More importantly, I believe we are about to witness a massive population migration as people with means choose to flee big cities for somewhere peaceful. The Panhandle does not have big city problems, nor is it anywhere close to a city. It doesn’t hurt that Florida has zero state income tax as well.

I suspect that every convulsion of COVID and tax stupidity will launch JOE shares higher and it will ultimately be seen as the way to “play” the stream of very wealthy refugees fleeing for somewhere better.

Sandridge Energy (SD – USA)

Sandridge has been a long-suffering position for us. While it was obvious that there was tremendous value to the company, the market refused to care. Now that the energy markets appear to have bottomed, investors are once again looking at Sandridge. With a net cash balance sheet and around $2 per share in expected free cash flow in 2021, it seems odd that it would trade for less than $2 for most of the year. During the fourth quarter, we finally were rewarded for our patience in owning and adding to our Sandridge position (remember, in investing, our biggest edge is our willingness to average down when something gets insanely cheap).

With President Biden banning drilling on Federal lands, companies with existing production, particularly of NGLs ought to experience increased earnings. While Sandridge remains in slow-motion wind-down (they manage their existing production but have stopped drilling new wells), that existing production will continue for a long time and is worth quite a lot today—especially with current basin differentials where they operate.

Dorian LPG (LPG – USA)

Dorian is a Very Large Gas Carrier (VLGC) company with low financial leverage, trading at roughly half of Net Asset Value. VLGC rates remain elevated as a result of rapidly increasing propane demand in Asia. I don't understand why LPG is this cheap as the macro fundamentals remain quite strong. We've owned LPG for quite some time and while the result has been disappointing, the Net Asset Value continues to build. In my experience, if that continues to happen, the shares will eventually revalue—especially as the company uses excess cash flow to repurchase shares.

Cornerstone Building Brands (CNR – USA)

Cornerstone is a producer of components for the construction of residential and commercial properties. In particular, they make critical components for entry level homes along with multi-family properties. As people continue to leave chaotic cities and high-tax states, they need to go somewhere--and a lot of that new supply must be built from scratch. Cornerstone is a primary beneficiary of this as they supply everything from vinyl windows to aluminum siding, from stone façade to gutters. While none of these components is particularly sexy, the company has had astounding returns on capital over the past few years—which was also a period when housing demand was somewhat slack. Now that demand is elevated, I suspect that returns on capital will improve from here. We purchased our shares for a low single-digit multiple on free cash flow. While the company is a bit more leveraged than I'd normally prefer, that leverage dramatically increases our returns should this housing cycle continue for an extended period of time. As cash flow increases and debt gets paid down, I suspect that Cornerstone will look dramatically less leveraged in a few more quarters—which likely leads to a dramatic re-rating of the cash flow multiple.

In summary, during the fourth quarter, we experienced unusually strong returns on our capital, despite a rather reduced level of exposure. With the market making new highs, I am struggling to find many value stocks to invest in. As a result, we continue to pivot more of our capital into Event-Driven strategies. From over twenty years of experience in the markets, I know that periods like this will not last. Our Event-Driven strategies will mean-revert, likely with a few calamitous months along the way. At the same time, currently overvalued stocks will one day become cheap again and we can focus more of the portfolio on value investing. My goal isn't to sit within a style box—it is to go where the opportunity is. There will always be opportunity in the markets. Let's hope I remain successful in pivoting as appropriate.

Sincerely,

Harris Kupperman
Chief Investment Officer

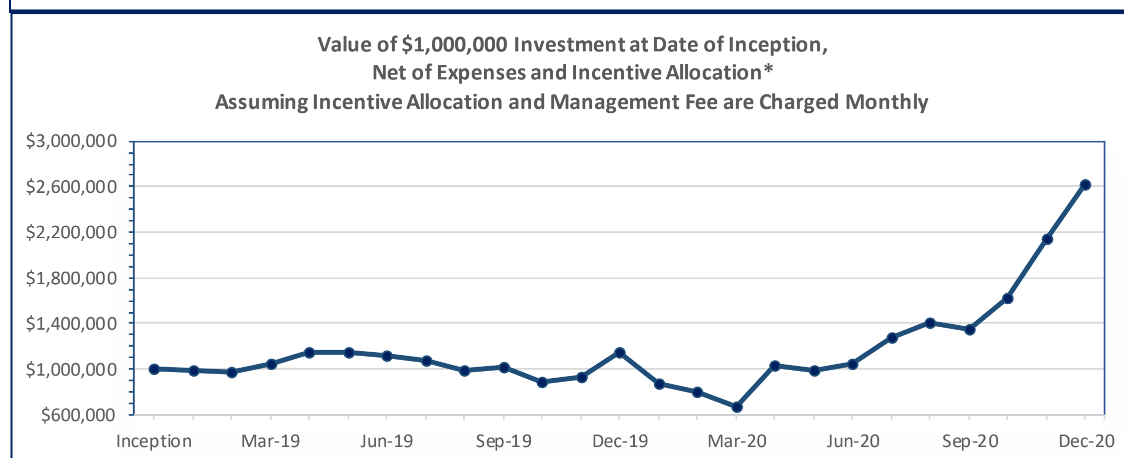
APPENDIX

Praetorian Capital Fund LLC Quarterly Returns		
	Gross Return	Net Return*
Q1 2020	-41.22%	-41.22%
Q2 2020	54.32%	54.32%
Q3 2020	34.09%	29.32%
Q4 2020	113.25%	93.94%
2020	**159.39%**	**127.51%**
Q1 2019	6.10%	4.88%
Q2 2019	7.99%	6.44%
Q3 2019	-10.51%	-8.40%
Q4 2019	15.34%	12.42%
2019	**18.27%**	**14.97%**

*Unaudited net return data is estimated, net of all fees and expenses (using the expense structure in place at the time)

Net Return Since Inception*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Full Year
2021													
2020	-24.62%	-7.18%	-15.98%	53.65%	-4.55%	5.23%	22.71%	10.22%	-4.38%	20.03%	32.50%	21.95%	**127.51%**
2019	-1.31%	-1.33%	7.71%	8.82%	0.63%	-2.81%	-3.18%	-8.08%	2.93%	-13.10%	4.26%	24.09%	**14.97%**



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