Edgebrook Partners, LP ("Edgebrook" or "Fund") – 2019 Letter to Partners

Dear Fellow Investors,

In 2018, our net return was +76%. In 2019, our net return was +13%.

We continue to have a great outlook. Edgebrook has more than +250% upside potential, looking out through the end of 2022. The upside potential today is similar to early 2003 and early 2009.

REALIZED HOLDINGS

During 2019, we realized (sold) three core positions.

XPEL, Inc. ("XPEL") – Our gain for 2018 can be entirely attributed to our largest position, XPEL. The Fund was a large shareholder – owning as much as 2.3% of the company – for over five years. XPEL pioneered the "self-healing" paint protection film category for the automotive industry and profitably grew sales from $11 million in 2012 to over $120 million in 2019. With large jumps in earnings, XPEL shares returned +343% in 2018 and +140% in 2019. After the tremendous stock appreciation in 2018, XPEL fell out of its position as one of our top five investment ideas. As a result, we sold our full position in early 2019, missing the stock's gain in 2019. XPEL will always be an "old friend" that we recall fondly.

LiqTech International Inc. ("LiqTech") – We sold our position in LiqTech in 2019 for a gain. After spending eight years and $60 million on development, LiqTech pioneered the leading silicon carbide membrane filter for marine scrubbers. We met twice with the CEO and spoke with several industry insiders to validate the company's growth prospects and technology. As the IMO 2020 regulation deadline drew nearer, LiqTech built a significant backlog of potential orders. Similar to XPEL, LiqTech had the potential for a 3-5x increase in earnings (and share price) within three years. As the company executed on its plan and caught the attention of numerous institutional investors, we sold our position in spring of 2019. Shares later retreated in November 2019 as the company cut guidance. The upside potential at that time was not compelling enough for us to reenter the position.

Atlas Engineered Products ("Atlas") – We sold our position in Atlas in 2019 for a slight gain. After a series of acquisitions, Atlas has been emerging as the only national supplier of roof trusses in Canada. Atlas currently has six facilities in three provinces (British Columbia, Manitoba, and Ontario). We visited the Vancouver Island facilities in 2018 and met twice with the new CEO in 2019. While the company enjoys local monopoly dynamics for roof trusses on Vancouver Island, the company faces stiff competition in other markets, especially Ontario. We did not observe enough stellar execution across its facilities and new product offerings (e.g. wall panels) for this company to remain a core long-term holding. We also question management's ability to allocate capital, as evidenced by the highly dilutive financing announced in December 2019. We will monitor Atlas as it remains on our short-list of investment candidates.

A lucrative investing approach can be to find a company that is: 1) the #1 market leader in a niche category and 2) in the early innings of significant earnings growth that is ignored or misunderstood by investors. XPEL and LiqTech are two recent examples of how this approach can work. As their earnings growth became increasingly understood, both companies' stocks soared – in a single year! – from valuations below $40 million to valuations above $200 million. When a company rapidly goes from being misunderstood to celebrating a NASDAQ listing and receiving invitations to give a presentation at institutional investor conferences, we are probably looking to exit our position for, hopefully, a very nice gain. As the late John Neff, CFA observed, "When you feel like bragging, it's probably time to sell."

INVESTMENT PROCESS

Once a year, it's helpful to pause and put one's investment process down on paper. At Edgebrook, we sit on the edge of a brook, patiently waiting to seize that big fish.

What does a "big fish" look like? To us microcap investors, a "big fish" is a microcap company with all three of the following necessary criteria: #1 Market Leader in a niche category, with Incentivized Fanatics who won't bamboozle us, with the potential to Grow Earnings (and the stock price) at least 3-5x over 3-5 years.

Overall, our investment process remains much the same as last year. However, there are two recent caveats. First, with few exceptions, we have narrowed our circle of competence to only three sectors: software, consumer products and industrial products. Second, we also evaluate private companies. For investments in private companies, we seek much greater upside potential over a longer horizon (specifically, we seek at least 10x upside potential over 5 years).

Each year, we meet in person with over 100 CEOs of small public companies in our search for "big fish." We continue to believe that these three criteria offer the best way to filter the few potential big winners from the hundreds of unremarkable microcap companies.

CURRENT HOLDINGS: SMALL, WEIRD ORPHANS

An apt question for an investment manager to ask himself or herself is "How do I become less competitive in order that I can become more successful?" In other words, what area has considerably less competition, such that I may successfully exploit its opportunities.

Over the last two years, we have found a handful of profitable, growing software companies that are much too small and way too weird for institutional investors and venture capital. In fact, we actively seek these small, weird orphans and will happily give them a home in our Fund.

With the proceeds from our former holdings, we have been building positions in four software companies (two marketplaces, two B2B SaaS). We consider these four software companies to be our nanocap version of FAANG (Facebook, Amazon, Apple, Netflix, Google). Amazingly, FAANG collectively appreciated in value roughly ten times over the last decade and 100 times over the last two decades! Assuming strong execution, our collection of nanocap software companies – a family of small, weird orphans – has the potential to appreciate ten times over this decade.

Wait, why invest so heavily in software companies? Perhaps a little history. Per long-time technology investor Roger McNamee, there have been three major eras of Silicon Valley: Apollo, Hippie and Libertarian. Roger McNamee, a leading buy-side technology investor since the early 1980s, was the only investor to be a 1:1 adviser to Bill Gates, Steve Jobs and Mark Zuckerberg. (Note: I'm grateful to have briefly met 1:1 with Roger in 1998 when I worked as an analyst at Bill Gates' family office. Thanks to Michael Larson, Bill Gates' CIO since 1994, for introducing us.)

Silicon Valley's first era was "Apollo", which ran twenty-seven years from 1945 to 1972. Here, the Space Race – and the closely related Cold War – was front and center in national attention. The birth of Silicon Valley's first era was at the end of WW2 and coincided with the invention of the transistor. Over two decades, the "Apollo" era escalated in intensity, moving from secretive Cold War programs like Operation Paperclip, to the Soviet Union's Sputnik success, to the Mercury program, to JFK's public speeches, to the Gemini program, and finally to Saturn V. The "Apollo" era culminated in 1969 with Apollo 11, the first human moon landing. In 1972, Apollo 17, NASA's last Moon landing mission, was completed and the "Apollo" era came to an end. (Note: While I wasn't even alive during the "Apollo" era, I absorbed stories from my late grandpa Fritz Karl Preikschat, who was the only engineer to work on both sides of the Space Race. The Soviet stories of the early space race are just as wild as "The Right Stuff" of America, but sadly no modern-day Tom Wolfe exists to write of them.)

The second era of Silicon Valley was "Hippie", which ran twenty-seven years from 1972 to 2000. Here, video games (defined by Atari and others) and desktop computing (largely defined by Apple and Microsoft) dominated much of Silicon Valley's attention. The "Hippie" era started with the birth of Atari in 1972. Steve Jobs, a Buddhist-leaning Hippie, worked at Atari as a technician before co-founding Apple with Steve Wozniak. Meanwhile, Paul Allen and Bill Gates' Microsoft pursued a mission of "a computer on every desk and in every home". With the mission of democratizing personal computing largely realized, the "Hippie" era came to an end in 2000 with the anti-trust decision against Microsoft and the subsequent NASDAQ crash. (Note: Like many youths, I played Nintendo video games and used a Mac and early PC. Later, near the end of this era, I played a tiny role as Bill Gates' equity trader, selling $5 B of Bill Gates' MSFT founder shares.)

The third era of Silicon Valley, in which we currently find ourselves, is "Libertarian". This era started in 2000 and may run twenty-seven years – yet again! – to 2027. (No, I'm not a futurist, but I like to meditate on the numbers. Fascinating to me, the number twenty-seven is the holy number three to the power of three.) From the vast rubble of Web 1.0 (that incredible wave of thousands of new Internet companies), a handful of Internet platforms emerged and became truly dominant. Most noteworthy, the category-killers of FAANG captured much of our consumer attention: Facebook in the category of social media, Amazon in e-commerce, Apple in smartphones, Netflix in streaming movies, and Google in search. Amazingly, this basket of Internet platform companies appreciated in value roughly 100 times over two decades, from 2000 to 2020! With the possible exception of Netflix, each of these companies solidified its competitive position in such an incredibly dominant way that only future anti-trust decisions by the U.S. government can arguably dislodge them.

Due to rising anti-trust concerns, it's hard to imagine the "Libertarian" leaders (i.e. FAANG) appreciating significantly from these levels. With their combined market value exceeding $4 T (that's T for Trillion), FAANG is arguably more than fully valued, given the long-term anti-trust risks. Rather than chase FAANG, we focus our attention on small software companies that have many more times the upside potential.

Our long-term thesis is that software companies who dominate a vertical niche will enjoy phenomenal success over the remaining years of our current era. At least through the end of the current era, software will continue to eat the world. Already, 1,000+ SaaS companies in North America enjoy revenue above $10 million, and 100+ marketplaces in North America have achieved significant scale.

Enter our nanocap version of FAANG. It's our family of small, weird orphans.

NameSilo Technologies ("NameSilo") – Founded in 2009, NameSilo is the #1 lowest cost domain registrar globally. In number of English-language domains, NameSilo is in the top ten globally out of about 2,500 ICANN-accredited registrars. Through a combination of lowest cost and high quality, NameSilo has experienced many years of organic growth with almost no spending on marketing. At year-end, NameSilo manages 3.3 million domains for over 240,000 customers with an 87% retention rate. Over the next 3-5 years, we expect the NameSilo subsidiary to double its domains and to add important new web services that could double its operating margin. A doubling of domains and a doubling of operating margin would yield a four-fold increase in operating profits and, we would argue, at least a four-fold increase in the share price. As of year-end, the Fund owns 4.3% of NameSilo.

Urbanimmersive ("Urbanimmersive") – Founded in 2007, Urbanimmersive is the #1 SaaS for real estate photography businesses in North America. We first met with the CEO in spring 2018. Urbanimmersive finalized its acquisition of Tourbuzz in fall 2018, which significantly expanded its U.S. customer base. After rationalizing its SaaS offering, the company became profitable with run-rate sales of C$4 million and gross margin above 90%. Though weighed down by significant debt in the form of convertible debentures, Urbanimmersive can potentially increase its market value by a factor of ten times by profitably expanding its immersive software services and growing sales from C$4 million to C$10 million. As of year-end, the Fund owns 4.3% of Urbanimmersive.

Riders Share ("Riders Share"; private) – Relaunched in 2018, Riders Share is the #1 P2P motorcycle rental marketplace (Note: P2P stands for "peer-to-peer".). Everyone knows Airbnb, the incredible P2P lodging marketplace with seven million listings and tens of millions of guests. Airbnb has also been an incredible early investment, a rare 1,000-bagger from its 2009 seed round (from a valuation of $6 million then to $31+ B today). As we know, Airbnb helped birth the "sharing economy", and several companies that are the "Airbnb of _____" (insert consumer asset that is highly priced and widely owned) have achieved tremendous growth and valuations:
Cars: Turo*, Getaround*
Dogs: Rover*, Wag
Boats: GetMyBoat, Boatsetter
RVs: Outdoorsy, RVshare
*Has been valued as a unicorn (value above $1 B).

In 2014-2015, I explored the idea of "Airbnb of RVs" but thought that securing insurance and dealing with foreign customers would be too hard. I passed. Today, Outdoorsy and RVshare, the "Airbnb of RVs", have a combined private value of around $400 million. Whoops! We missed the last "Airbnb of _____" winner? Maybe not. Motorcycles are a similar category to RVs. Like the ten million RVs, thirteen million motorcycles in America sit unused 95+% of the time.

In March 2018, the "Airbnb of Motorcycles", Riders Share relaunched with a robust software stack and the first national insurance policy for P2P motorcycle rentals. In two years, with under $1 million in funding, Riders Share has attracted 8,000+ motorcycles and 45,000+ user accounts. Users love being able to easily rent a premium motorcycle for 50+% less than a traditional brick-and-mortar rental location like EagleRider. This decade, Riders Share strives to become "the Netflix to EagleRider's Blockbuster" and scale to tens of millions in U.S. sales. Then there's Europe, a larger motorcycle market. It's been rather exciting to help guide the "Airbnb of Motorcycles", which enjoyed nearly +500% sales growth in 2019. (Special note: As of early 2020, Riders Share is again growing sales +500%.) As of year-end, the Fund owns preferred stock and a convertible note that, if converted to common shares, would give the Fund more than 10% ownership of Riders Share. I am on the board since August 2019.

Flex Rental Solutions ("FLEX"; private) – Founded in 2009, FLEX is the #1 SaaS company used by AV equipment rental vendors for live events. FLEX, a private company, is a low risk investment because it is consistently profitable and has no debt. FLEX enjoys 91% gross margin, steady growth, and a large customer base who track over 37 million pieces of equipment a year. Growth could accelerate with new modules, with the introduction of tiered pricing, with international expansion, and with targeted spending on sales and marketing. Overall, we believe that we were very disciplined on the purchase price, which, combined with continued growth, could result in a +1,000% gain on our investment before fees. A potential exit could be a sale to private equity or to a strategic buyer at a typical B2B SaaS multiple of 5x sales. Meanwhile, while we wait, we enjoy an 8% cash dividend. The Fund indirectly owns 4.0% of FLEX. I also invested from my IRA, which indirectly owns 1.8% of FLEX.

In summary, we have a family of small, weird orphans: NameSilo (public), Urbanimmersive (public), Riders Share (private) and FLEX (private). NameSilo and Riders Share are marketplaces. Urbanimmersive and FLEX are B2B SaaS. Three of the four enjoy operating profits and solid growth. While Riders Share is not yet profitable, the company is experiencing very rapid sales growth and improved gross margin.

As of year-end, the combined enterprise value of these four companies is only $44 million. Weighted by position size, our software portfolio trades at 1.0 times expected sales for 2020. Good luck finding a profitable, growing software company that trades at or under one-times sales!

The adventure in software companies is personal. I attended Stanford in the 1990s with three future members of the PayPal Mafia. In 2000, before PayPal went public, I was roommates with four fellows in SF. We shared an apartment at 402 Cole Street. Like the future PayPal Mafia, these four fellows would later go on to be founders of software companies. Remarkably, each of their three companies was eventually successful and achieved a valuation above $150 million. The 100% success rate is in stark contrast to the well-documented 90% failure rate for startups. Perhaps we're the 402 Cole Mafia? The three companies are Granicus (bootstrapped and then sold to private equity), Animoto (raised $30 million) and SkyKick (raised over $60 million). Not to be left out, I'm on a minor mission – along with you! – in software. We strongly expect that one or more of our small, weird orphans will "grow up" and also achieve a valuation above $150 million.

THIRTY-YEAR GOAL

In our last annual letter, I shared some detail on my career background and our thirty-year goal (2003-2032). Our thirty-year goal has been further refined: <u>from 2003, our thirty-year goal is to achieve 3x the overall gain of Berkshire Hathaway and the S&P 500 while making several "impact" investments</u>.

In order to achieve this goal, we will have to deliver an annual net outperformance of about +4%. For example, if Berkshire and the S&P 500 average +9% a year, we will need to average +13% a year in order to achieve 3x the overall gain. Compounding +13% over three decades yields a +3,812% overall gain, roughly 3x the +1,227% overall gain for +9% compounded over three decades.

Our thirty-year goal is bold and meaningful. The bold part of the thirty-year goal is to attempt to exceed, net of expenses and fees, the overall gain of Berkshire and the S&P 500 over a very long horizon. Over the last fifty years, beating Berkshire's +20% net returns over several decades by selecting and holding stocks was virtually impossible. In recent years, due to Berkshire's massive size, beating Berkshire's net returns over several decades is achievable. The seemingly impossible "four-minute mile" of beating Berkshire's returns over a few decades is in sight, and a few fund managers will achieve it. Sadly, my two deep forays into natural resource investing (in 2008 and again in 2014) severely impaired the long-term record. I take full responsibility for these deeply regrettable mistakes. Since 2003, our annualized net return is +12%. We're still in a position to achieve the thirty-year goal, but it will be very difficult, not unlike a "four-minute mile".

Besides a "four-minute mile", another analogy may help to explain the boldness of the thirty-year goal. Investing in microcaps is like searching for buried treasure in a vast minefield. Personally, I've found some treasure, but I've also lost a few body parts! Most of what we find in our search is either ugly rubble or explosive mines that end badly. However, a few gems reside in that vast minefield. Finding and holding a single gem can more than make up for getting repeatedly stuck holding ugly rubble and even the occasional explosive. Indeed, it only takes finding and holding a few gems in one lifetime to beat the market. Once in a rare while, a potential gem appears. If management and board nurture the company properly over many years, that rare growth company may turn into an investment gem.

In addition to boldness (i.e. a "four-minute mile", searching for buried treasure), there's meaning to the thirty-year goal. There's meaning and significance to supporting a small growth company, especially one that delivers spillover benefits for the environment. In recent years, we have had two profitable "impact" investments in companies whose technologies benefit the planet: Alter NRG (which was acquired for a significant premium in 2015) and LiqTech. These companies' technologies are engineered to clean up municipal solid waste (Alter NRG's waste-to-energy gasification systems) and fuel waste in the ocean (LiqTech's marine scrubber filters), respectively. It feels good to have a winning investment, and it feels doubly good to have a winning investment that actually helps heal the planet.

It's the second half of our thirty-year goal (2003-2032). Last year, our Edgebrook logo split into two colors, reflecting that we entered the second half of our thirty-year goal.

OUTLOOK

Overall, Edgebrook has over +250% upside potential, looking out through the end of 2022. The upside potential today is similar to early 2003 and early 2009. Historically, when the upside potential is above +200% – such as in early 2003 and in early 2009 – Edgebrook has performed very well.

NEW INVESTORS

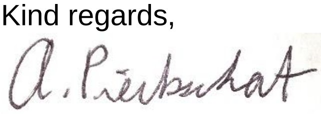
If you are similar to my family, you see hundreds of investment ideas each year. However, very few funds have all of the following characteristics:

- Great recent results (+99% over the last two years).
- Great future outlook (+250% upside potential over the next three years).
- Low correlation to the S&P 500 over the last ten years (+0.37), providing a significant diversification benefit.

In 2019, five new families invested in the Fund. In 2020, ten new families are expected to invest in the Fund. Meanwhile, I have 100% of my net worth, excluding my IRA, in the Fund.

Most importantly, **THANK YOU** for your continued interest and support!

Kind regards,



Andy Preikschat, CFA
Portfolio Manager

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Fund commenced on January 1, 2005, and is managed by the General Partner. Prior to January 1, 2005, the results are from the same investment strategy managed by Andy Preikschat, CFA as a managed account. Fund has management fees (1.5%; 1% prior to May 1, 2006) and performance fees (20% of profits). The managed account has been examined and retroactively adjusted to reflect the same fee structure. The managed account averaged five long positions, while the Fund has averaged six long positions.

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