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January 30, 2024

Black Bear Value Partners LP 2023 Year-End Letter

“The big money is not in the buying and the selling but in the waiting.” – Charlie Munger

To My Partners and Friends:

- Black Bear Value Fund, LP (the “Fund”) returned -1.1% in December and +17.7% in 2023.
- The S&P 500 returned +4.5% in December and +26.3% in 2023.
- The HFRI Index returned +4.4% in December and +13.8% in 2023.
- We do not seek to mimic the returns of the S&P 500 and there will be variances in our performance.

Monthly Performance Net of Fees and Expenses														
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year est.
2023	Black Bear Value Fund	1.0%	1.1%	0.8%	1.7%	4.4%	4.4%	-0.2%	3.3%	7.3%	-3.7%	-2.1%	-1.1%	17.7%
	HFRI Index - Value	4.6%	-1.3%	-0.2%	0.0%	-0.5%	3.9%	3.6%	-1.6%	-2.3%	-2.4%	5.0%	4.4%	13.8%
	S&P 500	6.3%	-2.5%	3.7%	1.6%	0.4%	6.6%	3.2%	-1.6%	-4.8%	-2.1%	9.1%	4.5%	26.3%

Summary Performance Net of Fees and Expenses						
	December	QTD	YTD	3Y	5Y	Inception
Black Bear Value Fund	-1.1%	-6.8%	17.7%	21.3%	12.2%	10.2%
HFRI Index - Value	4.4%	7.0%	13.8%	6.2%	9.8%	7.4%
S&P 500	4.5%	11.7%	26.3%	10.5%	16.0%	13.6%

Strategy Exposure @ 12/31/2023			
	LONG	SHORT	NET
Equities	86.7%	-54.2%	32.5%
Preferred Equity	0.0%	0.0%	0.0%
Credit Related	4.9%	-25.0%	-20.1%
Total Investments	91.6%	-79.2%	12.4%
Cash	45.0%	0.0%	45.0%
T-Bills	30.3%	0.0%	30.3%
Total Cash/T-Bills	75.3%	0.0%	75.3%

Note: Includes delta-adjusted options position

Note: Cash balances include cash received from our short positions

Top 5 Gross Long Positions & % Exposure			
Asbury Group	ABG	22%	
CONSOL Energy	CEIX	14%	
Builders FirstSource	BLDR	14%	
Altius Minerals	ALS.TO	11%	
Paramount Resources	POU.TO	10%	

Note: As 12/31/2023

Top 6-7 Holdings (Alphabetical)	
Prairie Sky Royalty	PSK.TO
Warrior Met Coal	HCC

Note: As 12/31/2023

Gross Concentration Breakdown	
	Long %
Top 5 positions	72%
Top 7 positions	87%

Note: As 12/31/2023

Note: Additional historical performance can be found on our tear-sheet.

Black Bear completed a successful 2023, returning ~18%, net, with substantially less overall market risk given our large short position. Our goal is to take sensible risk, protect capital and pursue appropriate risk-adjusted returns. We have a concentrated portfolio of our best ideas resulting in lumpy monthly numbers that are uncorrelated to broader markets. A fundamental methodology coupled with longer term capital gives us a distinct advantage.

The Fund has continued to grow both in assets and new Limited Partners (LP’s) ranging from high-net-worth to family offices. The Fund is blessed to have such high-quality LP’s that have a long-term and patient mindset. Thank you for being terrific partners. Our LP base is a big differentiator for us. We were able to donate our Q4 management fees to assist humanitarian efforts in Israel. Thank you to our partners on behalf of those organizations.



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I want to thank my family and specifically my incredible wife Lauren. This has not been an easy year for us and specifically Lauren, as we unexpectedly lost her dad. Arthur was an example of one of the best abilities in life... availability. He was always willing, without compromise, to be there for Lauren and our family even if it meant a last minute 12-hour drive from Atlanta. Starting Black Bear had its lonely moments, and I could always count on Arthur to encourage me to keep charging forward. He was a light in our lives and is sorely missed. Even with this loss, Lauren continues to be the backbone of our family which allows me to invest the necessary time and focus on the Fund.

Year in Review

Our Short of Silicon Valley Bank and The Unintended Consequences of Higher Rates

We have just exited a multi-decade period of low interest rates. The intended and unintended consequences can take many years to become evident. I am loathe to be too certain of any specific outcomes and feel that modesty, humility, and an open mind are going to be large determinants of investment success over the coming decades. Potential allocators are sometimes spooked by the investment manager who says “I don’t know” ... that view may want to be revisited.

Mark Twain has a saying that “it ain’t what you don’t know that gets you in trouble. It’s what you know for sure that just ain’t so.” This is an apt quote that one should hold dear when contemplating all investment decisions (and life decisions). It helps explain the unintended consequences that led to the regional bank failures as managements were focused on credit risk (the last war) and were comfortable with “knowing” the interest rate risk (the future battle).

The Fund benefited by ~2.6% from our shorts of Silicon Valley Bank (SVB) and First Republic. SVB’s management had taken a large amount of new deposits and invested in low-yielding government bonds and mortgages. As rates went up, the prices of those investments went down. Banks run on leverage so they experience a multiple of any loss (or gain). In this example, the prices were down enough where the bank was technically insolvent (if you were to liquidate the bank there wouldn’t be enough net value to pay equity holders). **This fact was not hidden in some obscure footnote or discussed in an off-the-record meeting. It was staring any and all investors in the face on the company’s balance sheet. Sometimes the best place to hide is in plain sight.** Few cared because this was not credit risk... The bonds would eventually be paid off in 4+ years and all would be ok. Absent a bank run there was no catalyst. And by golly they were right. Once it became clear the bank needed money to fill the hole, the catalyst emerged, and the depositors jumped ship putting SVB out of business in under 24 hours.

It is imperative to contemplate the fragility of the businesses one invests in and the underlying assumptions behind “conventional wisdom”. It’s often these assumptions coupled with a fragile business that can lead to unpleasant outcomes.

Inflation’s Coming Down – Why Is Everything Still So Expensive???

If you read the news or watch business TV, you will encounter many who talk about how healthy the consumer is and that we’re close to the “ALL CLEAR!” on the inflation front. Yet at the same time, individual consumers voice their anxiety and concern. How can both be true?

The answer comes down to base rates and the impact of “compound interest” on prices and inflation. We have experienced a dramatic 2-year inflation. Current prices on many goods and services are 15-30% higher and we are compounding off a much higher base. The power of compounding unfortunately hurts everyone’s



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pocketbooks, and it takes time to see the long-term consequences. The impacts of inflationary pressure will still be felt even if the future rates of inflation are in the 2-4% annual range. This concern informs both our shorts and our longs. **Pricing power has always been a core tenant of the businesses we own (and short) and will remain so.**

Looking Forward: 2024 and Beyond

For nearly 25 years interest rates went on a 1-way trip down and to the right. Money was nearly free, and all sorts of crazy financial behavior was rewarded. The government became one of the largest buyers of debt effectively funding the consumer and corporate spending. **At present, interest rates are HIGHER, but they are not high.** The government still holds a massive amount of debt, prices are up 20+% and we are only ~2.5 years from settling into post COVID life. There are consequential wars occurring in the Middle East and Ukraine with rising tensions in Asia. China is going thru its own digestive issues because of their level of debt-fueled spending. It is important to have a lot of humility in these kinds of markets where so much has been changing in such a short period of time.

The above concerns should not make you hide your money under your mattress, but it should give you pause in assuming the past is prologue. The importance of knowing what you own is as paramount as ever before. Owning companies with able management, good operations and healthy balance sheets will allow the companies to take advantage of the eventual bumps in the road.

Breakdown of PNL Components

<u>Category</u>	<u>Contribution</u>	<u>Top 10 PNL</u>	<u>Ticker</u>	<u>Contribution</u>
Equity Longs (Stocks we own)	48.4%	Equity Shorts	Varies	-25.3%
Pref Longs (Preferred we own)	1.2%	Builders FirstSource	BLDR	24.6%
Credit Longs (Bonds we own)	0.3%	Consol Energy	CEIX	7.1%
Cash/Tbills	1.8%	Warrior Met Coal	HCC	6.7%
Equity Shorts (Bets against)	-25.3%	Credit Shorts	Varies	-4.5%
Credit Shorts (Bets against)	-4.5%	Green Brick Partners	GRBK	4.2%
Total Gross Return	21.9%	Asbury Group	ABG	3.2%
		Sphere Entertainment	MSGE	2.5%
		Civeo	CVEO	-2.5%
		Penske Automotive	PAG	2.4%
		Total Gross Return		18.4%

Our investments in the homebuilding, energy/commodity, and auto dealership businesses were the largest contributors to our gains for the year. As we enter 2024 these themes remain a core part of our long portfolio. These investments far outperformed general market indices.

Our short portfolio largely lost money for the year. While we made money on our SVB/FRC shorts (the regional banks) many of the companies we were short gained in price, some dramatically so.

Our credit shorts lost money, largely due to the cost of carrying them.

Making money on cash is a welcome addition to the PNL. Being paid to be patient is a new phenomenon for the world!



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Credit Shorts/Equity Shorts

We had a large credit short spread across High Yield corporate debt (HY), Investment Grade corporate debt (IG) and Emerging Market corporate debt (EM). We closed out our HY short during the 4th quarter. The HY proxy we were short had a 3-year duration as opposed to the others who are closer to 8-9 years. As the treasury market is inverted (the 3-year rate is HIGHER than the longer rates) the Junk short required a rapid and violent default wave to make money. We moved on though we could revisit it later. We remain short IG and EM credit as they benefit from duration and underappreciated default risk. If the economy is super strong long rates likely stay here or widen and if the economy weakens spreads will widen.

We are short the equities of several Junk bond issuers. Many remain cash-burning or mildly profitable and require heroic expectations to justify their valuations. As the need to refinance approaches, the equity value could be called into question. Similarly, we are short companies in the private equity and private credit space. These companies are largely well run but have an immense appetite for low-interest debt. Many of their portfolio companies were purchased at high valuations and required lots of cheap debt. Their ability to match historical performance in an environment of increased interest costs, increased operating costs and more competition for capital will be a challenge.

Top 5 Businesses We Own

Asbury Group (ABG) – 22% of AUM

Asbury Group operates auto dealerships across the United States. The strength of the model comes from the back of the house in parts and services where more than 50% of the profits come from. We are exiting a period of high margins on new and used car sales. As inventories normalize and interest rates rise, I fully expect the dealers to make less profit (called the GPU) when selling a car. Less discussed is while profits per car are at all-time highs, the volumes sold have mirrored prior recessions. My expectation is that dealers will likely make less per car but will mitigate some of that pressure by selling more cars, especially used vehicles, as prices drop.

When an auto dealer sells a car to a consumer, they capture both the trade-in (inventory to sell) and the relationship for parts and services. It is a razor-razorblade model in a highly fragmented industry (many dealerships are owned privately by families). The large dealer groups have transitioned to an omni-channel model where much of the selling/pre-buy activity can be done online, reducing the need for headcount and making the transaction smoother for their customers. The lower operating costs of the business are not appreciated by the market. They are appreciated by us and the management teams as most dealers, including ABG, have been buying in lots of stock with their free-cash flow.

ABG should be able to earn \$30-\$40 in free-cash flow per share in a “normal” year. At year-end pricing that implies a 13-18% annual yield. I hope management continues to buy back a lot of stock at these levels!

Builders FirstSource (BLDR) – 14% of AUM

We have owned BLDR and been discussing the name since it was in the 50's (and owned lower). While it's up dramatically (trading around \$166 at year-end) it was still trading ~10% yield with modest leverage and encouraging prospects.

As a reminder, BLDR is a manufacturer and supplier of building materials with a focus on residential construction. Historically this business was cyclical with minimal pricing power as the primary products sold were lumber and other non-value-add housing materials. Since the GFC, BLDR has focused on growing their



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value-add business that is now 40%+ of the topline. The company has modest leverage and has **been using their abundant free-cash-flow to buy in over 39% of the stock in the last 2 years.**

While mortgage rates are higher, they are not unusual versus history. The low rates of the last 5-10 years are the outlier. We have a structural shortage of housing in the USA. With existing homeowners locked into low-rate mortgages, the aspiring homeowner may increasingly need to find a home from a homebuilder.

Normalized free-cash-flow per share looks to be in the range of \$15-\$17 per year. Margins are structurally higher given their increased shift into value-add products. At year end pricing of ~\$166 that implies a free-cash-flow yield of 9-10%. The pricing still does not reflect the long-term wind at its back or the pricing power inherent in value-add products.

CONSOL Energy (CEIX) – 14% of AUM & Paramount Resources (POU.TO) – 10% of AUM

We have a large investment across the energy & commodity spaces. We have not developed enough energy or commodity resources to satisfy the near- and medium-term needs of the world as well as provide for a renewable/less-carbon intensive future.

CONSOL Energy is an American energy company focused on the coal sector. The business has undergone a shift from being a majority producer of coal for domestic energy purposes to an export-driven producer of coal for non-power generation purposes.

While there is a negative stigma associated with coal (and some deserved) there are parts of the world that have limited energy alternatives and will require coal supply over the coming years. I expect the company to commit a large amount of the free-cash-flow to buying in cheap stock and the per share intrinsic value to grow substantially over the next 3 years.

Rough valuation thoughts on CONSOL.... Over the coming 2 years CEIX should generate \$20-\$40 in per share FCF. They own a marine terminal which is conservatively worth \$15-\$30 in per share value. Over the long-term the business should generate \$300MM+ of annual FCF. At reasonable multiples this comes out to \$60-\$100 per share. Add these related pieces up and you will arrive at a price of \$95-\$170 vs. a \$100 year-end stock price. Clearly in the short term, volumes and prices could be worse but over the medium-long term our downside seems limited given the lack of financial leverage.

Paramount is an ENP (exploration and production) in the energy space. It has no debt and ~\$580MM in cash/securities (16% of the mkt cap). Management is fully aligned with us as they own 46% of the Company. Over the next 2 years the company should generate ~10+% in annual free-cash flow presuming bearish energy prices.

Altius Minerals (ALS.TO) – 11% of AUM

Altius is a new addition to the portfolio. Altius explores and develops mineral properties through a unique setup. While they spend a small amount of upfront capital to explore and identify prospects, they utilize 3rd party partners for the capital-intensive drilling/mining in exchange for a royalty on the production. Their assets are diversified across potash, copper, lithium, and iron ore among others. Some of you may recall one of our more successful royalty investments in TPL (Texas Pacific Land). The beauty of a royalty structure is several fold. On the one hand, if there is increased volume of production, they get their share without any increase in their operating costs. The company doing the work pays for the labor/machinery etc. If the



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commodity price goes up it is pure “extra” profit to the royalty holder. Additionally on the way down there are very few fixed costs for the royalty owner as they can maintain a small number of headcount at HQ.

The management team is aligned (they own a good amount of stock), think like shareholders and has done an excellent job. We own the Company at 50% of the underlying value of the assets. An argument can be made that we own it close to 30% of the underlying value of the assets.

Charlie Munger

Though we never met, life would have taken a very different path without Charlie Munger’s influence. His rational way of thinking, direct communication and raw honesty have been an example many would benefit from. He was endlessly fascinating as he could speak on the widest range of topics of any investor or person I’ve encountered. I would encourage all investors (and people), new and old, to spend a lot of time studying Charlie and listening to his thoughts. May his memory be a blessing.

Fund Updates/Tax Discussion

An underdiscussed and often underappreciated aspect of fund management is taxes. I am pleased to report that we should have taxable income that is far less than our economic gains, most of which will receive long-term tax treatment. I anticipate K-1’s will be distributed with plenty of time for the tax-filing deadline.

Thank you to our service providers: BTIG (Prime Broker), EisnerAmper (Tax/Audit) and Kleinberg, Kaplan (Legal) for their help throughout the year. They have been helpful partners and been great sounding boards we encounter new “to-do’s” as we grow.

Concluding Thoughts

Looking back on our first 7 years I am pleased with how the business is progressing. The mission was to attract high quality LP’s who had a long-term mindset and wanted to invest alongside me. It’s a blessing to have this LP group and I will endeavor to deserve your capital in the go-forward years. Earlier in this letter I quoted Charlie Munger: “*The big money is not in the buying and the selling but in the **waiting**.*” We have subscribed to that ESPECIALLY when we own great businesses like Builders FirstSource and Asbury Group (which we have owned for several years). In an environment with increased interest rates and a tenuous geopolitical background, hunting grounds for opportunities will pop up from time to time. We will remain patient, thoughtful and WAIT, getting a little smarter everyday but be fully prepared to act decisively and with conviction when the opportunities present.

Thank you for your trust and support. Wishing everyone a happy, healthy, and PEACEFUL 2024.

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