PRAETORIAN CAPITAL

Q3 2024 Investor Letter October 20, 2024

During the third quarter of 2024, Praetorian Capital Fund LLC (the "Fund") depreciated by 2.29% net of fees. Given the Fund's concentrated portfolio structure and focus on asymmetric opportunities, I anticipate that the Fund will be rather volatile from quarter to quarter. During the third quarter, our core portfolio positions mostly declined, while the Event-Driven book produced a slightly positive return.

Praetorian Capital Fund LLC		
	Gross Return	**Net Return**
Q1 2024	11.90%	9.25%
Q2 2024	-1.76%	-1.69%
Q3 2024	-2.51%	-2.29%
YTD 2024	7.17%	4.94%
2023	34.70%	26.45%
2022	16.38%	11.95%
2021	181.80%	142.87%
2020	161.87%	129.49%
2019	18.71%	14.97%
Since Inception (1/1/19)	1371.73%	851.97%

Net return varies from gross return as it accounts for management fees and incentive allocations. Please see the additional disclaimers on the final page of this document.

During the first nine months of the year, effectively all of our net performance has come from the Event-Driven book, with a slightly negative return from our core book. This shows the power of the Fund's integrated strategy where the two books are meant to offset each other, especially in an environment where the core book has under-performed my expectations.

Fund Positioning

As we noted in the Q2 letter, we took exposure down dramatically in H1 and planned to do very little until Q4. It should therefore come as no surprise that Q3 was quite uneventful. Throughout summer we have cleaved off many smaller positions and have refocused and concentrated the book into our Core themes, leaving us with significant liquidity to flex up as we enter a possibly volatile Macro Dreamscape.

I have always believed that the only way to substantially outperform is to run a highly concentrated portfolio. When things are working, they tend to work beautifully. The flip side is that there will be times when this high level of portfolio concentration becomes a headwind to performance. To illustrate this point, during the first nine months of the year, in Dollar terms, the Fund has produced approximately $21.0 million of total P&L (before management fees). However, that figure is somewhat disingenuous as three large positions (our physical uranium entities, Valaris along with Valaris warrants, and St. Joe) produced a loss of approximately $20.5 million. More importantly, these three positions represented approximately 49.7% of our approximately $350.2 million of capital at the end of September. Not only did these three positions cost us money, but they also tied up substantial capital. As you can imagine, it's hard to swim fast when you're dragging an anchor.

I am not here to bemoan these three positions. Since this Fund's inception, they've done quite well for us as investors. However, they haven't been helping lately. That said, I remain quite bullish on all three of them, and expect that they will ultimately benefit us. Though, it's hard to know when that will happen.

During September, I dedicated substantial time to the first two of these positions, by attending the World Nuclear Association meet-up in London, followed by the Pareto Energy conference in Oslo. As far as I'm concerned, the theses behind our uranium and Valaris positions are quite intact—however, the timing of the next move higher remains uncertain. Meanwhile, St. Joe continues to suffer with many other housing names, despite the fact that it should be an inflation beneficiary on account of its large land bank.

I don't mean to bemoan the poor performance of these three positions, but rather note that underperformance of a concentrated portfolio happens almost as a matter of design, and sometimes it continues to happen for many quarters. As a concentrated investor, excluding our Event-Driven book, our returns are mostly the result of a handful of positions--this is simply part of the process.

What Makes Our Fund Unique

You may wonder why more fund investors are not invested in a concentrated manner, as studies have repeatedly shown that this is the best path to out-performance. The answer is that you will inevitably have periods where you underperform. This underperformance is often made far worse when you make an actual mistake—as opposed to simply owning securities that meander in a range after a period of appreciation.

Most hedge fund firms exist as marketing entities that happen to buy CUSIPs on the side. They cannot suffer through sometimes extended periods of underperformance. For that matter, they cannot flex up and down their exposure as nimbly as our Fund, as reduced net exposure also leads to periods of lower returns and the risk of an exodus of clients and employees. Additionally, many firms are benchmarked and marketing is quite difficult when you are running low net exposures, as short-term numbers can then diverge far from the benchmark. For us, this is an opportunity as we can take this risk of under-performance. We can take the risk of running low exposure as we await a fatter pitch. We are simply built differently. Conceptually, you can say that we're "unburdened by what has been."

I'm increasingly of the view that as an investor, the most money is made during periods when market participants panic, allowing us to purchase securities at highly discounted prices. These periods tend to be short-lived and somewhat random. I want to be prepared for the next such moment, whenever it appears. If this means that we continue to run with reduced exposure and lower returns in the short-run, I believe it will benefit us greatly in the long-run by allowing us to flex up at opportune times. Long term returns are a function of maxing out exposures at the right moment in time, and we intend to flex this exposure when the time is right.

I like to believe that this perspective has served us well in prior periods and will continue to serve us well in future periods. I also think that we can only employ such a mentality, because the majority of the 198 investors (including employees) in this Fund are private individuals and Family Offices, without the short-term performance pressure that frequently comes with institutional capital. This diversified base of clients subscribes to our ethos, and provides us with the mental flexibility, and patient capital necessary to run a concentrated book.

Economic Views and Positioning

As noted last quarter, I'm increasingly of the view that the US economy is slowing. How much it is allowed to slow before more fiscal and monetary stimulus are applied is hard to discern. However, it does appear to be slowing—particularly in sectors tied to the consumer.

As mentioned, I've used this knowledge to continue reducing exposure and improving the overall liquidity of the portfolio, by culling many of our smaller and less liquid securities. This harvesting phase is almost complete, with a few stragglers still left to be disposed of.

My expectation is that the economy continues to slowly deteriorate, until the next round of fiscal or monetary stimulus is unleashed. Given the upcoming elections, it's unlikely that this will happen until after we learn who's driving the bus, with the potential for extreme volatility along the way. This sounds like an environment that is tailor-made for reduced exposure, and maximum flexibility. That's how we're positioned.

I remain of the belief that most over-indebted Western Socialist Democracies will experience sovereign debt crises in the next few years. Given the precarious state of the US fiscal situation, accentuated by astronomical levels of future entitlements, it seems likely that the US will be the epicenter of this crisis. As a result, we continue to focus on owning securities that are weighted towards hard assets, with reduced exposures to real GDP and interest rates. In particular, we are focused on securities that should benefit from such a crisis, as opposed to being victimized by it.

Just to be clear, doomers have been calling for a fiscal crisis in the US, almost since I entered the investing business. They haven't been wrong; they've just been early. The US has been functionally insolvent for decades. The difference today is that the insolvency relating to entitlements has evolved from an actuarial insolvency into an actual cash flow crunch, as the boomers continue to retire, and draw on their entitlements. Cash is real, and the theoretical cash outflow predicted by the actuaries has now become reality. How governments cope with this accelerating crisis will be the defining investment theme of the next few decades.

Given that neither Presidential candidate has any desire to adjust entitlements, I believe that the cope mechanism will be money printing along with increased borrowing—both of which will weigh on bonds. This should then focus the coming crisis on interest costs, and those entities that are tied to interest rates, especially when you consider how levered our economy is.

Rather than think I'm worried as an investor; remember that I'm just a realist. Those who are positioned appropriately should prosper, instead of suffer. I hope for us to be in the former category. With bonds beginning to leak lower again, I believe we may finally be entering the moment when decades of doomers are finally resurrected as prophets—with this realization, should come volatility. As always, I crave volatility.

Position Review (top 5 position weightings at quarter end from largest to smallest)

Oilfield Services and E&P Basket (Valaris (VAL – USA), Tidewater (TDW – USA), other undisclosed positions)

In 2020 when oil traded below zero, drilling activity ground to a halt and many energy service providers declared bankruptcy. Many of these businesses had teetered on the verge of bankruptcy for years due to reduced demand and over-leveraged balance sheets. The bankruptcies led to consolidation and reduced future industry capacity, removing future competition in the recovery.

With oil prices now recovering, I believe that demand for drilling and other services will increase from subdued levels. While producers have been slow to increase spending on exploration despite recoveries in energy prices, I believe that this only extends the timing on the thesis. In the end, the only way to reduce future energy prices is to see a dramatic increase in global oilfield services spending. Any postponement of this spending only leads to higher prices and more wealth transfer from the global economy to the oil producers, which will likely end up resulting in an increase in spending on exploration and production.

We purchased many of these positions at fractions of the equipment's replacement cost, despite restored balance sheets and positive operating cash flow. As spending in the sector recovers, I believe that the potential for cash flow will become more apparent, and this equipment will trade up to valuations closer to replacement cost.

With the recent pullback in share prices, I've further increased our exposure to this sector.

Uranium Basket (entities holding physical uranium)

It may take some time still, but I believe that society will eventually settle on nuclear power as a compromise solution for baseload power generation. This will come at a time when there is a deficit of uranium production, compared with growing demand. As aboveground stocks are consumed, uranium prices should appreciate. Additionally, there is currently an entity named Sprott Physical Uranium Trust (U-U – Canada) that is issuing shares through an At-The-Market offering, or ATM, in order to purchase uranium (we are long this entity). I believe that these uranium purchases will accelerate the price realization function by sequestering much of the available above-ground stockpile at a time when utilities have run down their inventories and need substantial purchases to re-stock. The combination of these factors ought to lead to a dramatic increase in the price of uranium as it will take multiple years for sufficient incremental supply to come online—even if the re-start decision were made today.

A-Mark (AMRK – USA)

As the world gets increasingly crazy, I believe that people will come to realize that ownership of precious metals, in physical form, as opposed to in a brokerage account, is part of being financially prudent. They will mostly likely buy those coins from a coin dealer, either in person, or online. A-Mark supplies both of those markets as one of the largest players in online coin brokerage through their JM Bullion, LPM, Silver Gold Bull, Goldline, etc. verticals, along with serving as one of the largest wholesalers to local coin shops. A-Mark also has stakes in two mints (Silver Towne and Sunshine).

A-Mark benefits from periods of chaos in two ways. They see transaction volumes increase, and they see the spreads that they can charge widen. During the three years from Fiscal 2021 to 2023, A-Mark earned approximately $7 a share per year on average, if you adjust for certain non-recurring items and remove non-cash intangible amortization. We acquired our shares for approximately four times this earnings level, which seems quite cheap for a business with such high returns on capital. That said, the business has seen reduced earnings over the past few quarters, as a result of declining transaction volumes and spreads. I believe that this decline in activity has created a unique opportunity to buy a high-quality business, with substantial insider ownership, at a bargain price. I naturally am enamored of the counter-cyclical nature of the business, which hopefully should help offset the risks to our portfolio in future periods of crisis.

I believe that this business can earn as much as $10 a share in such a period of crisis, and get a healthy multiple applied to it.

For years, I have sought out a way to play an increase in the prices of precious metals, without the risks of owning a mine. I believe that A-Mark is the ideal proxy for this view and as other investors discover it, the valuation will re-rate.

St. Joe (JOE – USA)

JOE owns approximately 168,000 acres in the Florida Panhandle. It has been widely known that JOE traded for a tiny fraction of its liquidation 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 growing quite fast. I believe that JOE may grow recurring revenue at attractive rates for the foreseeable future, with earnings growing at a much faster clip. Meanwhile, I believe the shares trade at an attractive multiple on Adjusted Funds from Operations (AFFO), while substantial asset value is tossed in for free.

Besides the valuation, growth, and high Return on Invested Capital (ROIC) of the business, why else do I like JOE? For starters, land tends to appreciate rapidly during periods of high inflation—particularly an inflationary period where interest rates are likely to remain 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.

I suspect that every convulsion of urban chaos and/or tax-the-rich scheming 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.

Sprott (SII – USA)

Sprott is an asset manager that primarily manages exchange traded vehicles in various commodity sectors, with a focus on precious metals and uranium—two sectors that I’m quite bullish on. Sprott earns management fees based on the assets under management and in a virtuous cycle where they experience both inflows and asset appreciation, the fees should grow rapidly on a fixed cost basis, creating dramatic operating leverage.

I should note that on an earnings basis, Sprott is a good deal more expensive than most businesses that we tend to invest in. That said, I believe that this valuation is deserved and likely to increase due to the quality of the business and its scarcity value. With gold having made a new all-time high in US Dollars, investors will continue to seek out ways to gain leverage to precious metals, without the risks of mining.

In my universe of companies, only A-Mark and Sprott offer this sort of leverage with any amount of liquidity. As investors also discover this, I believe that they’ll bid both of these companies higher. While we could have just bought more A-Mark, I felt that diversification was warranted, especially as this Fund already owns in excess of 5% of A-Mark. Besides, Sprott gets us added exposure to uranium, a sector that I’m also bullish on.

Returning to the markets, during the third quarter of 2024, the Fund experienced a slightly negative return, and I remain quite frustrated by our results. We are positioned for a financial and economic crisis that always seems to be postponed by yet another quarter. In the interim, a handful of mega-cap tech stocks have dominated global market performances, making my conservatism look foolish. Markets go in cycles, and I remain convinced that my favorite names will have their day in the sun (eventually). Though, the waiting can be maddening.

I remain hopeful that as inflation accelerates and the fiscal situation in most developed markets deteriorates, our positions will appreciate.

Sincerely,

Harris Kupperman
Founder & Chief Investment Officer

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Appendix

Praetorian Capital Fund LLC Quarterly Returns		
	Gross Return	**Net Return**
Q1 2024	11.90%	9.25%
Q2 2024	-1.76%	-1.69%
Q3 2024	-2.51%	-2.29%
YTD 2024	7.17%	4.94%
Q1 2023	-1.78%	-2.09%
Q2 2023	9.79%	8.00%
Q3 2023	15.04%	11.92%
Q4 2023	8.57%	6.85%
2023	34.70%	26.45%
Q1 2022	19.79%	15.55%
Q2 2022	-18.16%	-15.69%
Q3 2022	0.01%	-0.30%
Q4 2022	18.69%	15.26%
2022	16.38%	11.95%
Q1 2021	57.50%	45.66%
Q2 2021	28.14%	23.96%
Q3 2021	11.42%	9.85%
Q4 2021	25.32%	22.44%
2021	181.80%	142.87%
Q1 2020	-41.22%	-41.22%
Q2 2020	54.32%	54.32%
Q3 2020	34.09%	29.32%
Q4 2020	115.28%	95.63%
2020	161.87%	129.49%
Q1 2019	6.10%	4.88%
Q2 2019	7.96%	6.44%
Q3 2019	-10.23%	-8.40%
Q4 2019	15.44%	12.42%
2019	18.71%	14.97%

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