July 9, 2024

RE: Letter to Limited Partners, Q2 2024

Dear Partners,

The fund returned 0.05% (net of all fees and expenses) for the second quarter of 2024, an abbreviated reporting period given our June 1st launch.[1]

Net Performance

	2024		Since Inception*	
	Q2*	**YTD***	**Total**	**Annualized**
Aventine Capital Partners LP	0.05%	0.05%	0.05%	n/a
MSCI ACWI ex-USA[2]	-0.10%	-0.10%	-0.10%	n/a
S&P 500[3]	3.59%	3.59%	3.59%	n/a

**June 2024*

Portfolio Composition

Top 5	Top 10	Long	Short	Net
21.7%	23.6%	23.6%	0.0%	23.6%

Geographic Exposures

North America	Europe	APAC	Emerging
8.2%	12.9%	0.0%	2.5%

We're one month into operations and I'm pleased to report that everything is functioning as expected. I'm excited about the businesses we're buying and the prices we're paying. There's a compelling opportunity set and I'm deploying capital in a disciplined and opportunistic manner.

The following top five holdings accounted for 21.7% of the portfolio (alphabetical):

Alight: This US-listed benefits management firm provides outsourced administration of healthcare and retirement benefits for mostly enterprise clients. 70% of the Fortune 100 and 50% of the Fortune 500 are clients. Revenue is 93% recurring with 98% retention. Alight was a division of Aon that was acquired by Blackstone in 2017. Blackstone installed a new CEO to transition the business from a service-center oriented offering to a highly automated cloud-based platform. Alight IPO'd via SPAC in July 2021. Unlike most SPAC targets, the business was profitable and cash generative before its public listing. Revenue is growing organically in the mid-single digits while margins are expanding as clients transition to the cloud. We have been able to acquire shares for 8.5x my estimate of midterm free cash flows and less than half the earnings multiple of slower-growing peers.

Groupe Bruxelles Lambert: This Belgian-listed holding company is controlled by the Frère (Belgian) and Desmarais (Canadian) families. It manages a concentrated portfolio of public and privately held operating businesses, as well as an asset management business and a mature, self-funding portfolio of LP stakes in PE and VC funds. In keeping with its family ownership, GBL takes a long-term, owner-operator view towards generating economic growth and is often an engaged controlling shareholder in the businesses it owns. The public portfolio is concentrated among well-established businesses including SGS SA, Pernod Ricard and Adidas, while the private portfolio is primarily comprised of two European retail healthcare roll-ups that are growing at double digit rates. Debt is modest at 10% loan-to-value and liquidity is high at €3.7bn. In response to the historically high discount to NAV, the company has launched an accelerated buyback program to repurchase €500m of equity through June 2025. We have acquired shares in GBL at a 41% discount to NAV, offering a strong margin of safety given the generally high quality of the portfolio.

Heidelberg Materials: This German-listed materials business is one of the world's largest vertically integrated cement, aggregates and ready-mix concrete manufacturers. It has operations in over 50 countries on five continents, including leading market positions in Western Europe and North America. Critically, it is a leader in the development of CO_2-reducing technologies, an important differentiator as regulatory schemes increasingly tax carbon emissions (most notably in Europe). After years of global expansion, the board has shifted its focus to per-share value creation. They have de-levered the balance sheet, introduced a material share repurchase program, and most recently indicated that they will address the severe undervaluation of their North American operations, a strategy successfully pursued by multiple peers in recent years. North America represents 28% of group EBITDA but if valued in line with US peers is worth 60% of Heidelberg's enterprise value, leaving the rest of the business trading at just 3x EV/EBITDA. We've acquired shares at a 12% levered FCF yield and below 4x my estimate of mid-term EV/EBITDA.

Totvs SA: This Brazilian company is a dominant provider of Enterprise Resource Planning (ERP) software. It has 50% market share among smaller firms in Brazil and a 34% overall market share, competing at the larger end with SAP, Oracle and Microsoft Dynamics. The CEO, Dennis Herszkowicz, has overseen the successful transition from license to subscription sales and is now expanding the offering to include ERP-enabled financial services, CRM and marketing platforms. As with all ERP businesses, the revenue is extremely sticky: Totvs has 98% revenue retention and is growing sales at double digit rates. The business is cash generative and has a large net cash position earmarked for acquisitions but recently directed at share repurchases. We were able to acquire shares for below 3x my estimate of mid-term recurring revenue and 10x EV/NOPAT, less than half the valuation metrics of slower-growing international peers.

Vistry Group: This British homebuilder utilizes a differentiated model of partnering with public sector entities and property managers to develop or redevelop land into residential communities for sale, for rent, and for government subsidized homes. Unlike traditional homebuilders, Vistry's partnership model requires less upfront spending on land, allowing for returns on capital employed that can exceed 40% and a less cyclical earnings stream. In November 2022, Vistry acquired its only national competitor, Countryside PLC, becoming the de facto incumbent builder of affordable mixed tenure housing in the UK. Vistry's CEO, Greg Fitzgerald, is a proven operator with a multi-decade track record of UK homebuilding experience. He is supported by a deep bench of executives and a refreshed board with notable shareholder representation. The UK remains structurally underbuilt, particularly for affordable housing. We were able to acquire shares at 11x next year's earnings and less than 6x management's midterm earnings target.

And we're off

"I used to think that being great at investing long-term was about genius. Don't get me wrong, genius is still good, but more and more I think it's about doing something reasonable, that makes sense, and then sticking to it like grim death through the tough times."

– Cliff Asness

I've built Aventine with a singular objective: to maximize our cumulative net returns by fostering an environment that promotes sensible decision-making through good and bad times. Many things contribute to this approach: the structure of our partnership, the types of businesses we own, my avoidance of financial leverage at the fund and company level, and perhaps most importantly, the partners I'm able to attract.

The investment strategy I've developed over the last 15 years relies on several basic principles, the most fundamental of which is that price fluctuates more than value. As usual, Warren Buffett said it best: "price is what you pay, value is what you get." This is in stark contrast to momentum-based strategies that prioritize price while remaining agnostic to value. It's worth noting that even passive index funds, most of which are market-cap weighted, are implicitly momentum-based; they increase the weightings of companies whose stock prices go up the most, while reducing the weightings of those that decline the most.

Our strategy involves making concentrated investments in unloved businesses while avoiding popular (and often overvalued) companies. I focus on fundamentals, underwriting the cash generating potential of a business and stress-testing its operations through a market cycle. My job is to identify price/value dislocations and then tightly manage the only thing I have real control over: the price I pay for a security.

Our best IRRs will be generated as we excitedly buy down the businesses I already know and love should the market give us the opportunity. Doing this requires partners (you) who understand this strategy and who have the fortitude to stick to it like grim death through the tough times. How we behave when things get tough is far more important than how we behave when things are easy. Patient capital that can be actively invested through moments of market volatility is a powerful form of arbitrage that you enable.

There are some tradeoffs to focusing on value over price that partners must be comfortable with. Most obviously, I cannot control the timing of when the two will converge. I try to put the odds in our favor, by seeking out catalyst-rich situations where skilled management teams can effectuate change, but even then, the disconnect can linger or worsen. As a concentrated portfolio, this means our unrealized mark-to-market returns may be volatile in the short term.

Volatility is a friend of the patient investor. It lets us take advantage of irrational pricing, buying when prices are cheap relative to value, and selling when they're expensive. This may sound simple, but in my experience and observation it is quite difficult to consistently execute in practice. Our partnership is designed to maximize this straightforward but powerful objective.

As the fund is only four weeks old, I'd like to reiterate its core attributes:

1. A portfolio of uncommon businesses held for the long term. Low turnover and 10-15 core positions.

2. Investments across geographies and industries, but only within my circle of competence.
3. The avoidance of significant financial leverage at both the portfolio and company level.
4. Comfort holding a large cash balance in the absence of compelling expected returns.
5. Transparent communication from me.

Please refer to the Owner's Manual for a more comprehensive discussion of the investment strategy.

What gets me excited?

I'm acutely aware that we have launched this partnership at a time when many market indices are at all-time highs. You probably are too. Aventine Capital Partners is designed to be an evergreen platform that will invest through cycles. For Day One investors, however, it's reasonable to ask "why now?"

As a disclaimer I must emphasize that the themes discussed here do not direct my investment strategy, which is a resolutely bottom-up, fundamentals-driven process. Rather, these themes give me confidence – even excitement – that our strategy has tailwinds supportive of future outperformance.

When I look at global markets today I see three dominant themes: (1) extreme concentration in the largest – mostly US tech – businesses, (2) the sustained underperformance of so-called value investing strategies, and (3) the sustained underperformance of non-US markets. I'll briefly address each in turn.

<u>Market concentration</u>

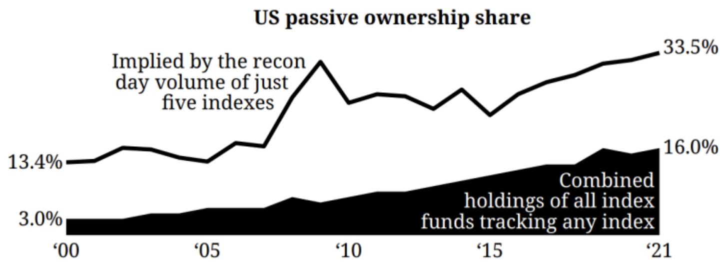
If you put $100 into the S&P 500 index today, you are buying $37 worth of just ten companies. These ten companies collectively trade for 30.3x forward earnings, 48% above their 28-year average of 20.4x. The rest of the index trades for 17.6x forward earnings, just 12% above its long-term average of 15.7x.

Since the start of 2021 the collective equity value of the "Magnificent 7" has doubled, driving over 50% of the S&P 500's returns, while the rest of the index has risen a cumulative 20%. Nvidia, a single company, is responsible for 31% of the S&P 500's first-half advance this year.

While most of these largest companies are excellent businesses, that doesn't justify owning them at any price or in any portfolio weighting. The ten largest stocks haven't had this high of an index weighting since the Nifty Fifty era in the 1960s. In 2000 they peaked at 27% and as recently as 2016 they were just 18%. Owning the index today involves concentrated exposure to a handful of potentially over-valued businesses.

Source: FactSet, S&P, J.P. Morgan Asset Management.

And yet that's exactly what more and more investors are doing on an increasing scale. Passive ownership of stocks, led by the rise of index ETFs, has grown from 13% of the US stock market in 2000 to an estimated 34% today. Passive index strategies were designed to democratize low-cost equity exposure, but their rise has had the unintended effect of reducing the proportion of price-sensitive investors in any given company. Passive strategies are inherent price takers – they buy or sell based on their own investor flows, not the valuations of their holdings. The ongoing shift of capital from active to passive strategies increases the potential for price/value dislocations. Additionally, the most popular passive strategies generally underweight or exclude small cap companies, further exacerbating this dynamic.

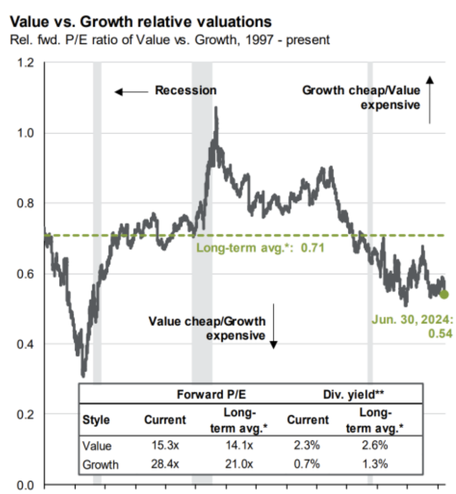


Source: Working Paper, Alex Chinco (CUNY) and Marco Sammon (Harvard): "The Passive-Ownership Share is Double What You Think It Is", April 2024

In a market downturn, all stocks tend to suffer as capital leaves in a panic. I believe this effect is only growing with the rise of passive investment vehicles. The largest shareholders in most companies today are Vanguard, Blackrock and State Street. They buy and sell purely based on investor flows, not valuation. This excites me. The best trading counterparties are those with non-fundamental motivations.

<u>The underperformance of value</u>

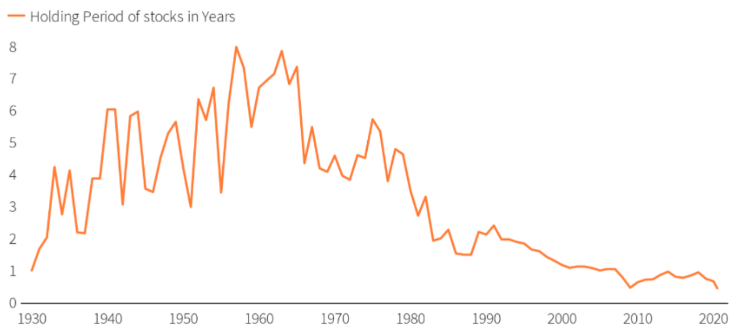
Over the last decade, so-called value-based factors have impressively underperformed growth factors, triggering speculation that value as a strategy has lost its utility. Technological disruption, the rising role of intangible assets and expectations of perpetually cheap capital all challenged Ben Graham's principles of valuation. Charts such as the one below are frequently advertised to highlight this undervaluation. While I agree that value investing *as a cohort* has underperformed, I think these charts can be misleading. Yes, discount-to-book valuation strategies have lagged growth-based strategies. But tangible book value matters less than it once did and is increasingly a misleading sign of value.



Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management

As discussed in the Owner's Manual, I subscribe to the notion that valuation matters, and that stocks can be purchased for discounts to intrinsic value – as measured by owner's earnings, cash generation and replacement cost. I don't blindly rely on "screenable" metrics such as price-to-book or reported earnings multiples to identify margins of safety. Doing so is lazy and unlikely to generate outperformance. The most attractive investment opportunities often don't screen as cheap (if they screen at all).

One core element of value investing that I wholeheartedly subscribe to is duration. My turnover is low, and if underwritten correctly, I remain a happy buyer as holdings get cheaper, and a reluctant seller as my estimates of fair value are reached. This approach is in sharp contrast to the market at large, where holding periods have declined for decades. In the 1960s stocks were owned for an average of over six years. By 2020 this had declined to 6 months. This statistic is misleading as it measures total turnover and therefore incorporates the huge growth in quantitative trading strategies over the last 30 years, but it still speaks to a broader trend of institutional and retail investors "trading" rather than "owning" stocks.



Source: NYSE, Refinitiv. Note: Holding periods measured by value of stocks divided by turnover

This offers us an enormous opportunity. If you can sit on your hands and wait for a fat pitch, higher market turnover is a good thing. As Graham's famous dictum goes, in the short run the market is a voting machine, but in the long run it is a weighing machine. Higher market turnover increases our ability to buy when market participants are despondent sellers and to sell when they are irrational buyers.

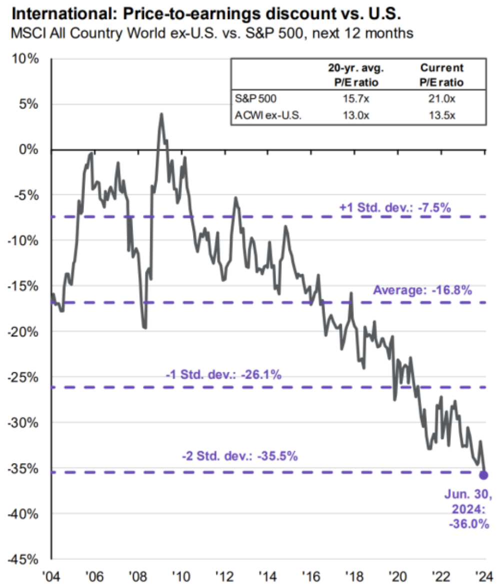
<u>The underperformance of non-US equity markets</u>

Look internationally and the rationale for value-based investing becomes even more compelling.

Our partnership has a global mandate and will seek out the most attractive risk-adjusted returns wherever they might be. Non-US markets have materially underperformed US stocks for most of the last thirty years. Over the last decade in particular, non-US stocks (as measured by the MSCI ACWI ex US index) have compounded at 3.8% while the S&P 500 has compounded at 12.2%, leading to massive US outperformance.

Much of the US outperformance has come from multiple expansion, not just earnings growth. The S&P 500 currently trades at 21.0x forward earnings, over one standard deviation above its 20-year average 15.7x. Compare that to the rest of the world trading at 13.5x forward earnings, barely above its 13.0x average.

Put that together and, as the charts below show, international markets today are trading at an historic 2 standard deviation discount to the US when measuring forward earnings multiples, and a 2 standard deviation premium when measuring dividend yields (a rough proxy for FCF yield, where higher = cheaper).



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management

One can, of course, look at this data and come to the opposite conclusion, extrapolating that over-exposure to large-cap US tech is a winning proposition. This has clearly been true for many years. There is no denying that the US is an exceptional market, and indeed I expect the partnership to have a healthy exposure to American businesses. But to believe that the valuation disconnect between the US and the rest of the world will continue to expand, you must believe the rest of the world is broken, which I do not.

Index-level valuation metrics are statistics I generally avoid, but to state the obvious, an index is the amalgamation of individual businesses. The cheapness of non-US equity markets suggests fertile hunting grounds in which to identify a few extremely compelling businesses. I observe that non-US markets offer cheaper equity valuations for businesses of equal or in some cases higher quality than their US peers. Heidelberg Materials and Totvs are two such examples.

As I mentioned above, these comments are an uncomfortable departure from my typical focus on individual company fundamentals. You shouldn't expect macro-based commentary or decision-making from me in the future. I've included this only as a sketch of why I think broader conditions are accommodative of my strategy in the years ahead.

The businesses we're buying today trade materially below my estimates of intrinsic values, but that doesn't mean they can't trade cheaper still. I gain confidence from the quality of management and the durability of their capital structures and product offerings. I believe we own best-of-breed companies capable of gaining market share through a cycle and compounding capital for many years.

In Closing

In future quarters you should expect a similar letter format, summarizing the top 5 holdings and briefly discussing a theme relevant to how I manage our portfolio. These letters will likely be short, often repetitive, and will avoid any attempts at macroeconomic commentary or forecasting. A year-end letter will go into greater detail on exited positions.

While I'm very happy to discuss any investment at any time, I don't intend to publish "pitches" on existing holdings. One of the benefits of public equity investing is the ability to change your mind and exit a position with little or no negative impact. I retain the right to change my mind and don't want to expose myself to the anchoring effect of planting a flag in a public way. Don't worry, you'll hear about all my mistakes in the year-end letters.

Thank you for your confidence and support. As one of the largest investors in the fund, my experience is the same as yours. The Founders' Class remains open, and I'm appreciative of introductions to investors you think might be a good fit.

Please don't hesitate to reach out with any questions or ideas.

Sincerely,

Philip B. Berkman
General Partner

Direct: 312.548.8423
Mobile: 617.866.8388
Email: philip@aventinecap.com

[1] All performance figures represent unaudited net performance estimates for partners that made initial contributions at the inception date in the Founders' Series of partnership interests. Individual partner returns may vary depending on the timing and series of their investment. The partnership is audited on an annual basis.

[2] The MSCI ACWI ex USA index captures large and mid-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 85% of the global equity opportunity set outside the US. It is a total return index inclusive of net dividends received.

[3] The S&P 500 includes 500 leading companies in the U.S. and covers approximately 80% of the available market capitalization. It is a total return index inclusive of gross dividends received.

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