March 14, 2019

Introduction

This initial letter will provide some background about me and how my career and investing philosophy have developed over the years. It's probably too much detail for many of you, but given that I hope Sorfis will be my main focus for the rest of my investing career, I think it's worthwhile to give you a written overview describing how I made my way from growing up in Ohio to starting Sorfis in Charlotte, North Carolina.

A Personal History

I grew up in a small town in Northeast Ohio, and I used to describe my childhood as "normal." As I've gotten older, I've realized that it's easy to think that what's familiar is normal or typical, and that much depends on the place and time into which one is born. Now, I think a better description of my early years is "lucky." I was born in a country and at a time—and also had an extremely supportive family—that allowed me to develop and pursue opportunities that so many around the world don't have.

Small, random events can often have a major influence on one's life. For me, one of those random events that would lead me to value investing many years later happened when I was 13. I was at a friend's house; we were looking for something to do, and we saw his dad's golf clubs. We had never played, but had a friend who did. So we called him, and we all went to play golf. I got hooked on the game, and not long thereafter, started working at that same golf course where I first played.

Getting that initial job made a big difference in my life. While I can't claim it quickly rid me of the immaturity of youth, it was a big leap in learning the importance of responsibility. While there were plenty of unglamorous aspects to the job, I worked with some great people and made some terrific friends. Plus, for the introvert that I am, having to constantly communicate with customers and manage busy weekend mornings and outings was invaluable experience that helped me build confidence at a young age.

The job also came with another perk: free golf. I played a lot! During my last two summers of high school, I probably spent more of my waking hours at the golf course, either working or playing, than I did at home. I wasn't good enough to consider playing college golf, but decided that I wanted to pursue a career in the golf business, as it was the thing I knew best at the time. One of my friends and colleagues told me about the Professional Golf Management (PGM) programs. There were less than

a dozen schools with PGM programs at the time, and one of them, Coastal Carolina University, was located right next to the golf capital of the world: Myrtle Beach.

I spent my first two years at Coastal in the PGM program. After that time and a couple of great internships, I realized that the golf business wasn't for me. I was around plenty of people with both more passion and more skill to be in that line of work than I had, so I went looking for something new. At about the same time, the Wall Fellows Program at Coastal was accepting applications for its new class of students. It was a program aimed at preparing students for their last jobs, not their first jobs. I applied, and after a lengthy interview process, was lucky enough to get accepted.

The Wall Fellows Program included internships as part of its core curriculum. In the summer between my junior and senior years of college, the program set me up with an internship in Belgium. It was a great experience, especially for someone who had never before traveled abroad, and gave me a look into the world of corporate finance and marketing. One of the major advantages of internships is that not only can one potentially figure out what one wants to do at an earlier age, but one can also figure out what one does not want to do. As with my golf internships, I am glad I had this experience and worked with some amazing people, but I realized that that world wasn't what I wanted to pursue for a career.

And then, back at Coastal for my senior year, I took a class on investments with Dr. Gerald Boyles, and found what I wanted to do. Investing was so much more interesting to me than anything else I'd done thus far, and like the game of golf when I first picked it up as a kid, I was hooked. Dr. Boyles was a great teacher; and unlike many college investment professors, he also brought some real-world practicality into the classroom, and was my first introduction to the term "value investing" and to Berkshire Hathaway CEO Warren Buffett.

After graduation, and with some help and a recommendation from Dr. Boyles, my friend and classmate in the Wall Fellows Program, Matt Miller, and I went to work for Mike Pruitt in Charlotte, North Carolina. Mike had studied under Dr. Boyles at Coastal about 20 years before Matt and I, and had named his company after the mascot of our shared alma mater, Chanticleer Holdings, Inc.

Matt and I served as analysts, and looked at a number of public, private, and early-stage potential investments; with the goal of eventually opening a fund at Chanticleer modeled after the partnerships run by Buffett in the 1950s and 1960s, which we did in January 2007. While we were appreciative at the time, upon further reflection I've come to realize just how lucky we were to work for someone right out of college who both allowed us to pursue the deep curiosity we had for investing as well as provided us with some tools to help in the pursuit. Attending the Wesco Financial and Berkshire

Hathaway annual meetings, and meeting other investors—including Buffett and Munger "groupies," (as Berkshire Hathaway Vice Chairman Charlie Munger calls us)—only helped to fuel the curiosity.

It was, of course, an interesting time to get started in the investment business (and a lucky time). Lessons, both good and bad, can be learned vicariously through others, but the ones learned through one's own experience seem to stick best. Observing, first-hand, the final leg of one of the great housing bubbles in history and its subsequent bust provided an experience in market cycles and psychology that will stay with me for the rest of my life.

There's a story I once read, though I don't know whether or not it is actually true, about a broker during the 1987 stock market crash with more than 100 clients. Almost every one of them called the broker on the day of the crash, and all but two of them sold everything they had. The two that didn't sell had one thing in common: they were both more than 80 years old, and they both instructed the broker to buy whatever he could. They were old enough to have been through the cycles of greed and fear, and knew that in times of panic, it was best to ignore the crowd and do the opposite.

While we didn't possess the experience of the wise, older investors in the story above, we did have older, wiser heroes such as Buffett and Munger whom we had studied deeply during the few years leading up to the major downturn in 2008 that helped mold our philosophy about needing to be greedy when others are fearful. Our fund was still tiny, and our investors were friends and family, so the value philosophy—combined with not wanting to lose the money of people we cared about—kept us pretty well focused on trying to find and buy the best values that we could find.

Fast-forward a few years, and while we had recovered nicely from 2008, the fund was still too small to sustain itself, and Chanticleer Holdings' restaurant operations were becoming its dominant economic force. As we were in the process of figuring out what to do about the fund, which Matt and I were passionate about, but which was just too small, an institutional investor offered to provide us seed capital to get to a sustainable size. Given the complexities of running the fund within Chanticleer's public structure, we needed to form a new entity, and so we came to an agreement with Mike, and left Chanticleer in 2013 to start Boyles Asset Management.

While at Chanticleer, we mostly looked at and invested in small- and micro-cap companies, especially those with market capitalizations below $100 million. As we started Boyles, we gave ourselves the flexibility to invest in larger companies, but given our accumulated base of knowledge about tinier companies and where we thought we saw the best values, we mostly stayed focused on those smaller companies, and mostly ones based internationally.

After a couple of years, we were trailing our benchmarks by a decent margin. While our conservatism in putting the new capital base to work and a strong dollar versus the foreign currencies in which we

were invested didn't help, we also made some mistakes. Some positions didn't do well, especially relative to most stock markets around the world, and plenty of things we either almost bought or bought in small size performed well as we mostly watched from the sidelines. As we closed 2017 and started getting close to the five-year anniversary of Boyles in early 2018, our underperformance versus the benchmarks had grown larger, and our seed investor decided to withdraw from the fund. Given that this investor represented a large percentage of the fund's assets, we decided to close down Boyles, which we finished doing at the end of 2018.

The literature on achieving expert performance through 10,000 hours of "deliberate" or "deep" practice has been popular during the last several years. The success of practice for the fundamental, bottom-up investor is harder to judge than when mastering disciplines such as chess or a musical instrument, for example. Investing arguably involves more judgment, more luck, and an ever-changing playing field. What's more, the investor's feedback—measured by business performance versus expectations at the time of investment—can take years to become apparent. But the process of analyzing mistakes, learning from others, and continuing to expand one's circle of knowledge to achieve mastery is similar in investing as it is in other domains. Though unlike other domains, expertise in the world of investing is more dynamic. Studying the past is not sufficient; one also needs the filters and focus necessary to navigate a future that is uncertain and largely unknowable.

As I was thinking about what to do next—how to keep learning, improving, and moving forward in my path toward higher investing expertise—I started to think about some of the dichotomies in the world of investing. Sometimes the best action is inaction. Sometimes the best returns come from the worst businesses, and the worst returns from the best businesses. Sometimes growth creates value, and sometimes it destroys value. Sometimes the most important things one needs to predict are unpredictable. And oftentimes, the hardest things to do in the near-term are the best things to do for the long-term.

And therein lies the decision to move ahead with Sorfis. The short-term decision to start small and nimble leads to what I hope will be a multi-decade effort in painting my own Sistine Chapel, to borrow the analogy used by Buffett in this excerpt from his 2003 talk at the University of Nebraska at Lincoln:

> I can do anything in the world I want to do, but what I want to do is run Berkshire Hathaway. Now, why do I want to run it that way? There's a couple of things:
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> [First,] I get to paint my own painting. I go down there every day, and I feel like Michelangelo working on the Sistine Chapel or something. Nobody else may think it's a great painting, but I get to paint my own painting. I do not have people second-guessing me. I do not have people saying, "Why don't you use a little more red paint,

> or blue paint? Why don't you paint a seascape instead of a landscape?" I get to do my own thing. It's a form of creativity. It's exactly like somebody feels that's a professional golfer, or like somebody feels that's a painter. They're not doing it for the money, primarily. They're doing it because they like doing something well, and that happens to be down the route of their talents.
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> And the second thing I like, frankly, is I like applause. I like appreciation. So I like having shareholders who feel good about what I've done.... Everybody in our family has got all of their money in Berkshire, and so those people are counting on me. And that's kind of fun to have something where you can actually deliver for other people, and change their lives in positive ways.

Structure and Philosophy

I'm a value investor. That may mean different things to different people, but my definition defines value investing as simply trying to acquire more than one is paying for. It's not about price-to-book or price-to-earnings multiples, and I far prefer a growing business to a non-growing business, but my process is to just try and buy things for less than they are worth.

I view valuation as uncertain, wide-ranging, and non-static. Business values are always changing based on the decisions being made by the people running those businesses, and the quality of their efforts needs to be assessed when thinking about the attractiveness of an investment. The markets are probably mostly efficient most of the time, but that's a big difference from being highly efficient all of the time. And one of the major advantages one can have in the market is the behavioral advantage of being able to focus on where a business will be in 5-10 years instead of where it is today when assessing its investment merits.

Our initial investment structure at Sorfis is separate accounts. This will allow me to both keep costs low and keep our operations fairly simple so that I can spend most of my time focused on reading and thinking. And while many may define our strategy as value or fundamental investing, our real strategy is to do that reading and thinking—and to follow the insights I occasionally get from those efforts.

I believe in the importance of both concentrating in one's best ideas, as well as being willing to hold cash when there aren't enough understandable ideas with enough margin for error in which to invest. If fully invested, I'd expect to have anywhere from 3 to 30 equity holdings, depending on the attractiveness and correlation of opportunities; but most likely, a portfolio of 6 to 12 core holdings is where I expect we'll fall on the scale of concentration. This concentration means we'll likely be more volatile, when fully invested, than most investment managers. But I will be invested in the same

holdings as investors, and I believe this is the best way to achieve fully aligned long-term success. Given that I also expect the majority of our investors will use Sorfis as one of several managers, with more diversification at the manager level, I believe this extra volatility in the pursuit of long-term returns is worthwhile.

I plan to be agnostic on both the size and the location of the companies in which we invest. Sometimes the best investments are the small companies most people have never heard of, and sometimes they are household names hiding in plain sight. I have a preference for companies in the United States, but as long as companies report in English (so that we can do the work, reading, and thinking necessary to understand the business), we're willing to go where we think there's value and the prospect of low risk and good returns.

One of the other advantages we can have is a great investor base that thinks long-term and understands both the cyclicality and unpredictability of markets. We'll look smart at times, and dumb at times, but that's the nature of the market and investing. While we don't have a lockup for our investor capital, it's important that our investors only invest capital with us that is appropriate for a long-term time horizon (at least 5 years).

Our promise to investors is that our interests in a successful relationship are aligned, and that we'll wake up each day trying to become a little wiser and better than we were the day before.

All the best,

Joe Koster

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Investment Strategy

Absolute Return Strategy

- Will focus on individual stocks, both in the United States and internationally.
- Will create a portfolio of approximately 6-12 undervalued securities (when fully invested), though the range could vary anywhere from 3-30 securities, depending on circumstances.
- Will hold cash when unable to find attractive places to allocate capital, which may make up a substantial majority of investment portfolios at times.
- Investment Minimum: $100,000.
- Management Fee: 1% per year.
- Custodian: Interactive Brokers.

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