Asheville Capital Management Introductory Letter

Asheville Capital is an investment firm based in North Carolina that provides accredited investors and institutions with portfolio management services. The company is majority owned and operated by Jake Barfield.

Asheville Capital seeks to compound its investors' capital at rates of return that consistently exceed relevant benchmark levels. This will be achieved via a proprietary research and analytical process that surfaces companies with attractive valuations and high probabilities of growing intrinsic value at outsized rates. We expect to concentrate our capital in 5-15 securities and to take 10-year investment time horizons. This forces every investment to meet an extremely high bar for inclusion and mitigates the dilution of time, attention and returns on lower-conviction companies. It is our belief that this can be accomplished without incurring unnecessary risk.

In a nutshell, *we expect to invest in world-class companies before they are broadly recognized as such*. Said another way, we will invest with conviction in exceptional companies when we hold a differentiated opinion on its long-term prospects, with a high probability of occurrence. This conviction is only achieved after diligently researching the company's opportunities and becoming comfortable with the associated risks.

Qualitatively exceptional companies have common characteristics that are identifiable well in advance of quantitative proof of such excellence. [1] Exceptional companies express unique value propositions and defensible competitive advantages that allow them to grow sales and profitability at faster rates than the markets they operate in. When a competitive advantage is paired with a large addressable market, abundant reinvestment opportunities, and a competent management team, there is often potential for long-term compounding.

By nature, qualitative characteristics are difficult to quantify and are therefore not easily arbitraged away. They present themselves early in the lifecycles of the company and are visible to the careful observer years before a retrospective quantitative screen identifies it as such. *It is a foundational belief at Asheville Capital that qualitative components drive future quantitative values and while markets are good present-day observers of quantitative information, they are rarely good predictors of subsequent performance.* [2]

While foundational to our approach, we are not unique in holding this belief. Plenty of ink has been spilled on competitive advantages and the superior returns that follow. [3] Our distinction lies in our ability to identify companies early, our exhaustive process to underwrite them appropriately, and the wherewithal to invest with an unusual degree of conviction for an unusual length of time.

We believe that there has never been a better time in history to be invested in equity markets. Innovation is occurring across the world at a pace that has never before been witnessed. This results in tangible global net wealth creation and higher qualities of life for nearly everyone. On the whole, technological advancement is beneficial to society, and we look forward to investing in companies that are key contributors to this global overarching trend.

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[1] Quantitative proof being sales figures, profitability ratios, and returns on capital
[2] Parts of this idea were borrowed from Howard Marks' memo, *Thinking about Macro*
[3] See writings from Warren Buffet, Michael Porter, or Bruce Greenwald

Research Process

Any future compounding of capital at excess returns will ultimately stem from our ability to a) identify exceptional companies before they are broadly appreciated as such and b) to pay an attractive price for them. We submit that the former is the hardest of the two, and that if you can consistently execute this digging process, the latter opportunities will present themselves. *Equity prices are liquid and fluctuate wildly, whereas intrinsic value of exceptional businesses generally move in one direction.*

We believe that the lifetime buy-and-hold equity return of our investments will closely mirror the return on capital per share of each business. Therefore, the starting point for every company that we observe is to determine if there is potential for incrementally high returns on capital into the future.

Capitalism works. [4] If a company is earning a high rate of return in a market but lacks a unique defensible advantage, capital will inevitably flow into the industry and returns will be competed away. Only advantaged business models will earn excess return over multi-year periods.

Therefore, if we are going to find companies that are going to produce high returns on capital into the future, we must find a competitively advantaged business first. Competitive advantage leads to high returns on capital and growth of intrinsic value which leads to equity appreciation at similar rates.

There are two great things about competitive advantages. They enable the generation of high returns on capital deployed and they often go underappreciated for extended periods of time. Things like barriers to entry, network effects, switch costs, brand power, or scale economics often present themselves years in advance of free cash flow generation, but ultimately reveal themselves in the form of excess profits.

How do you quantify the future estimate of intrinsic value for a business with network effects? I would argue that you examine the cost to acquire incremental customers and measure that against the payback rates that you expect to receive for multiple years into the future. It is simple (not easy) to do this and arrive at an estimate of the expected rate of return, but in doing so I implicitly place predictions at the heart of my estimate of current value. Not everyone will agree on the appropriate method for valuing the security, much less in the underlying predictions themselves. This difference of opinion of future value leads to fluctuations in present value and if the company fits our definition of exceptional, it often triggers an interesting opportunity for us.

Patience

A final ingredient that will result in compounding our capital at excess rates will be our ability to hold our investments for multi-year periods. Most equity investment funds are incentivized to ignore the return potential of a long-term compounder and cash in their winnings today because the loss of foregone upside is never captured in performance data. "It is never wrong to take a profit" goes the conventional wisdom. [5] However, the loss of foregone upside… the failure to hold a position that goes on to outperform is a very real opportunity cost and one that most investors are incentivized to ignore when staring down a short-term period of appreciation. *Internally, we will track the rate of return of equities that we sell in order to mitigate omission errors.* We believe this will quantify the loss of foregone upside and incentivize us to

[4] Even in societies that are not officially 'Capitalist'

[5] Parts of this idea were borrowed from an excellent article in the Financial Times, written by Lawrence Burns and entitled 'Why it is usually a mistake for investors to take profits.'

continue to hold equities with the highest expected risk adjusted rate of return. By concentrating our capital for multi-year periods we minimize two things, dilution, and the loss of foregone upside.

Without incurring unnecessary risk

Ultimately, taking measured risks with disproportionate reward potential is what we expect to be compensated for.

We have a unique attitude towards risk in managing our portfolio. Most managers will diversify their portfolios to mitigate the effects of price volatility. As market prices fluctuate it is tempting to attempt to smooth those returns over time. While we agree with the principle that diversification is generally good, we do not believe that managing for diversification's sake is an effective means for generating superior investment returns. In fact, price volatility is not the central risk that we expect to incur over a multi-year period. The central risk is the fundamental business risk that our underlying investments face. It is our belief that, while dislocations occur, the market will eventually value a business according to its fundamental ability to produce cash flows for its shareholders. Therefore, the primary risk to the shareholder is the risk that the company does not go on to produce the estimated cash flows per share.

We believe that diversification itself is a good thing and we will seek to achieve it whenever possible. But if we are going to produce returns that beat the market on a consistent basis it will be by taking thoughtful, measured risks with disproportionate reward potential. Those risks are primarily fundamental. *High conviction due diligence is the first and most important mitigant of risk.*

Fee Structure and Capital Raising

We will charge a 1% management fee and 20% of excess performance above the MSCI All Country World Index, our most relevant benchmark. We are seeking to align our interests with the interests of our investors and will only receive performance fees when our investors achieve returns above our benchmark. If we can't outperform over multi-year periods, we can't justify the existence of this partnership and you should invest your capital elsewhere.

Our intention is to be very thoughtful about the amount of capital that we take in and intend to close the fund to new investors at $500 million of assets. This is subject to change going forward and dependent on the opportunity set in addition to our ability to maintain sufficient liquidity in each position. We are cognizant of the fact that size is a detriment to returns and the time taken to raise capital is a distraction from the work required to generate excess returns. We will market ourselves in order to make this a sustainable business, but it is not our intention to raise capital in a way that adversely affects our ability to generate returns.

It is our hope to find investors who are highly aligned with this investment strategy, who are as patient as (or more patient than) we are, and aware of the potential for choppy short-term returns in any given period.

Thank you for your consideration of Asheville Capital. My hope is that you have found this letter informative and that you see a high alignment of interests. Please feel free to reach out to discuss further – jake@ashevillecapitalmanagement.com or (704) 219-2623.

Appendix Item 1: A Monologue

Until now I (Jake) have spoken in the first-person plural, using terms like 'we' and 'our', although Asheville Capital will really just be a one-person shop to begin with. I have done this because I view this as a partnership between myself and our investors. Additionally, I do not expect to remain a one-person shop forever and I am writing this as much for my future fellow co-workers as I am for our potential investors. [6] But now I would like to discuss my personal background and my motivations for doing this.

My journey into this career path began as a 19-year-old college student. My parents were divorcing and were teetering on bankruptcy. I learned that I was going to be on my own financially going forward and if I wanted to attend college, I was going to have to find a way to pay for it myself. I decided to enlist in the Army National Guard (MOS: 31-B, Military Police) partly because I genuinely wanted to serve in the military, and partly because it would enable me to complete my bachelor's degree debt-free.

During training (Fort Leonard Wood, Missouri), I found that I had several hours most evenings before 'lights out,' so I began to fill it by reading books. I have always been a voracious reader but reading went into hyperdrive during these nine months of training because I was absent of all distractions with a pile of books and ample time. [7] I began with personal finance books and over time grew increasingly interested in the possibility of not only saving my money, but also of growing it. So, I pivoted towards investing books, where I would allocate the majority of my attention going forward. By the time I reached graduation from training, I had read over fifty books in personal finance, investing, basics of accounting, social sciences, behavioral psychology, and a few other miscellaneous texts. I was a good soldier too and graduated second in my class with honor graduate distinctions.

Everything else that follows in my professional history flows from this major turning point in my life. I served in the National Guard for six more years until my contract expired. During that time, I earned my bachelor's degree from Western Carolina (and met my wife along the way), interned at a boutique investment bank in lower Manhattan, worked as a consultant to investor relations teams, and completed my master's degree at Boston College. While at BC I completed an independent study with Arvind Navaratnam, a professor of fundamental analysis (and a successful investor). We spent eight months studying some of the top performing businesses of the last four decades. Through this work, I began to understand (in a real way) the key qualitative differentiators of businesses and their effects on corporate trajectories over long enough time periods.

After Boston College I went to work for Nine Ten Capital, an investment firm that was then based in Austin, Texas. Here I put learnings to practice and began to research companies professionally for the first time. I spent three years at Nine Ten focused on finding domestic small-cap equities that would be a good fit for our focus list and/or portfolio. Nine Ten and its portfolio manager, Russell Mollen, invest in a highly concentrated manner with 8-12 holdings at any given point in time. It was at Nine Ten that I began to specialize in deep-dive due diligence on a company and learned with increasing efficiency how to detect the distinguishing features of a company that separates the elite investment opportunities from the merely above-average.

[6] I do expect to hire 1-2 analysts when scale allows. I look forward to answering your question in person about how, when and who I expect to hire.
[7] Apologies to any of my drill sergeants if you are somehow reading this. I couldn't mop the floors for four hours *every* night.

I then worked for Bares Capital doing the same type of work, except applying it to international-only companies across all market capitalizations. Through this work I learned that the number of opportunities for attractive returns in international markets far outnumber those available in domestic small cap alone. For a lot of businesses, other countries present far more favorable competitive landscapes than in the US. As such, exceptional international businesses tend to produce cleaner unit economics and higher payback rates than their US-based comparables. Additionally, there is a preference in international markets for companies to tap public lines of capital at earlier stages in their growth cycle, therefore giving us (the outside investor) extremely long runways to grow and compound our capital. But I digress, back to my personal history.

I am now living in Asheville, North Carolina with my wife (Sage) and our two twin children (Clark and Laurel; 2-years old). I fill my non-working time playing with my kids, reading, exercising at our local CrossFit, playing chess, working on our small plot of land tending chickens (and soon to be goats!), or coaching my nephew (Easton) in his local t-ball league. I am launching this firm out of a long-standing desire to step out on my own coupled with a high degree of conviction that this investment process can provide value and am joined by a group of investors (one in particular, Kevin Walbrick) who similarly believe in me and are willing to provide capital to get it off the ground.

Appendix Item 2: The Asheville Capital List of "Nots"

Below is a list of items that other investment managers are sometimes exceptional at, but that we do not do at Asheville Capital. It is not exhaustive, but my hope is that in detailing here the things that we do not do, you will get a better idea for what we do best.

1. We do **not** short – there is a negatively asymmetric return profile, and we do not specialize in timing the market.
2. We will **not** own commoditized businesses – due to the lack of defensible advantages.
3. We will **not** own overly indebted businesses – because it is hard to generate exceptional returns on capital per share to equity investors when you have to pay back your debtholders first.
4. We will **not** own businesses that are overly dependent on external factors – as these businesses often have no control of their own growth trajectory or operational leverage.
5. We do **not** intend to be activists in an investment – We would prefer to avoid investing in turnaround companies in the first place. There will be instances in which we are wrong in our investment thesis. In those cases, we would typically rather sell our position than to take on added execution risk.
6. We do **not** arbitrarily determine position sizes – each holding will be weighted based on an objective ranking of expected return relative to risk.
7. Our top priority is **not** asset gathering – It is to generate top percentile returns. Rate of return is our scoreboard. If we provide value to you (our investors), we expect for Asheville Capital, the business to thrive.
8. We are **not** overly reliant on discounted cash flow models – DCFs are one of many helpful valuation tools. We take quantitative valuations seriously, while also acknowledging their shortcomings as well as the false sense of security that one can fall into by placing an unwarranted degree of faith in their accuracy.

9. We are **not** an ESG fund – Although we align highly with some ESG-related initiatives. We believe that the best companies in the world tend to produce genuine value to all constituents and therefore we will avoid companies that are harmful to producers, consumers, or the environment, engage directly or indirectly in human rights violations, or contribute negatively to society at large. There is no scenario where we will sacrifice our personal values to generate a return. We would argue that companies that do engage in these lines of business are going to be increasingly subject to societal and regulatory burdens that hamper our ability to project their cash flows as well.
10. We do **not** feel a need to formulate or express an opinion on everything – We try to eat our humble pie daily, and that starts with an acknowledgement of our own limitations. We **do** expect to look across all market capitalizations, industries, and geographies, but we do **not** expect to, or feel a need to formulate an opinion on each of them. Our research begins with a broad understanding of markets, and then goes very deep into the individual sectors and businesses that we deem likely to yield the highest expected return.
11. We do **not** wish to own more than 10% of the shares outstanding in a business – Only in rare exceptions will we ever constrain ourselves from a liquidity perspective.
12. We will **not** immediately sell a position that has risen dramatically in stock price if the long-term thesis is still intact – We will fight this gut reaction whenever possible if the long-term thesis is still in place. Over a long enough period, errors of omission (or selling a compounder too early) are the single greatest risk to the generation of portfolio excess return. One step we are taking to try to curb this is to track the ongoing performance of our sold positions alongside our portfolio returns. This is not a number that I have ever seen tracked by any other portfolio managers. Our aim is genuinely to generate top percentile performance and we will only achieve this through the compounding of investments above our cost basis and the mitigation of the error of selling those exceptional businesses too soon.