

# Wide Moat Investing



## ***Seven Corners Capital***

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Scott Klarquist: President, CEO and Chief Investment Officer

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## Who We Are

### Is Seven Corners A “Hedge Fund”?

Please note that Seven Corners is not a hedge fund. Rather, it is an investment research and management firm. However, Seven Corners intends to solicit clients in a manner similar to a typical hedge fund. Client assets will be held in separate accounts and not commingled. Like many investment firms that also manage pooled funds, Seven Corners intends to manage such separate client accounts according to a common investment strategy. Seven Corners’ investment strategy utilizes many of the same techniques employed by long/short equity hedge funds.

Seven Corners also intends to publicize its research via its website and blog, as well as through third-party investment websites, such as Seeking Alpha. Seven Corners’ goal in doing so is to obtain valuable feedback from the investment community and thereby “stress test” our investment theses. In addition, Seven Corners hopes to establish a reputation for high-quality research within the investment community, thereby gaining a following among investors for our ideas.

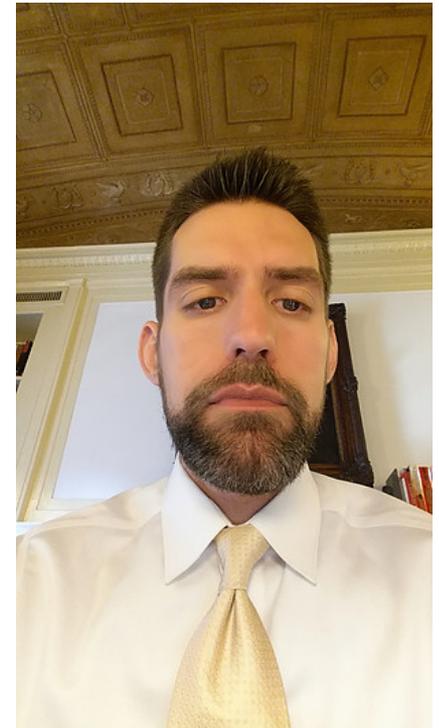


## Who We Are

### Resume of our President, CEO and CIO

Scott Klarquist is the President, Chief Executive Officer and Chief Investment Officer of Seven Corners Capital Management, LLC. Mr. Klarquist began his career as a corporate attorney at several New York law firms, and was most recently with Dentons LLP. After making investments for his personal portfolio for approximately 6 years while still working as a lawyer, Mr. Klarquist decided to pursue investing full-time. He managed his personal funds as a private investor for several additional years before opening Seven Corners in 2016.

Mr. Klarquist graduated with honors from the University of Virginia with a Bachelor of Arts degree in English. He also holds a Juris Doctor degree from the University of Virginia School of Law.





## **Our Philosophy – How to Invest?**



**First, We Need to Define Investment versus Speculation**



## Investment versus Speculation

The Investor





# Seven Corners Capital

## Investment versus Speculation

The Speculator





## Investment versus Speculation

### Definition of “Investment”

An investment operation is one where you look to the asset itself to determine your decision to lay out some money now to get some more money back later on. So you look to the apartment house, you look to the stock, you look to the farm in terms of what that will produce. And you don't really care whether there's a quote under it all. You are basically committing some funds now to get more funds later on through the operation of the asset.

### Definition of “Speculation”

Speculation is much more focused on the price action of the stock. Because you are counting on whatever factors, could be quarterly earnings, could be it's going up or it's going to split or whatever, but you are not looking to the asset itself. And the real test of what you're doing is whether you care whether the markets are open. If that's the case, then to some extent I'm speculating because I'm thinking about whether the price is going to up tomorrow or not.



## Investment versus Speculation

Investment	Speculation
Deep Fundamental Analysis	Minimal Fundamental Analysis
Long Time Horizon	Short Time Horizon
Choose Undervalued Securities	No Preference Under/Overvalued
Do Not Need Market Quotes	Constantly Checking Quotes
High Conviction	Medium to Low Conviction
Concentrated Portfolio / Best Ideas	Diversified Portfolio / Random Ideas
Buy More if Price Declines	Sell Out if Price Declines
Scalable to Large Amounts of Money	Not Scalable / Limited by Liquidity
Low Tax Rate (LT Gains)	High Tax Rate (ST Gains)
Compounding over Time	Minimal Compounding
Let Winners Run (see, e.g., BRK-A)	“Never Go Broke Taking A Profit”



## Investment versus Speculation

### Why Compounding Matters

Growth of \$10,000 Over Time

Year	5%	10%	15%	20%
1	10,500	11,000	11,500	12,000
5	12,763	16,105	20,114	24,883
10	16,289	25,937	40,456	61,917
20	26,533	67,275	163,665	383,376
50	114,674	1,173,909	10,836,574	91,004,382

Picking the Right Investment is *Far* More Important than the Timing of the Investment



# *Seven Corners Capital*

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## Investment versus Speculation

Investment = Rational Allocation of Capital (No Emotions Involved)

Speculation = Gambling (Usually Emotional)

How to avoid speculation? Adopt the correct mindset with respect to the market and its daily gyrations. In other words, it's about temperament, not IQ points.



## Investment versus Speculation

### Effect of “Trading” on the Brain...

Associate Professor Brian Knutson of Stanford University found that the brain can cause investing mistakes, or at the very least, affect the decision-making process.

In a recent study, Knutson found that “positive aroused feelings associated with anticipation of gain (e.g., ‘excitement’) may promote risk taking, whereas negative aroused feelings associated with anticipation of loss (e.g., ‘anxiety’) may promote risk aversion.”

Studies have also found that the brain activity of someone whose investments are making money is indistinguishable from that of someone who is high on cocaine or morphine [GREED], according to Jason Zweig, author of *Your Money and Your Brain: How the New Science of Neuroeconomics Can Help Make You Rich*.

Zweig also cites research that found the more frequently people were told they were losing money, the more active the brain’s “fear center” became, causing a surge of adrenaline and other stress hormones which have been found to “fuse” memories [FEAR], making them more indelible.

So not only does losing money cause physical stress, the memory of the loss burns itself into your brain, affecting future decisions when it comes to investments. Remember THAT the next time you think about making a quick trade.



## Investment versus Speculation

Avoid Emotion, Embrace Rational Thought

Market Environment During Trading Hours = Flashing Red & Green Lights, Stocks “Soaring” or “Plummeting”, Investors “Glued to their Screens”, Breathless CNBC Commentators, Rush to Buy and Rush to Sell = Overstimulated, Irrational, Emotion-Driven Environment Feeding People’s Innate Gambling Instinct

***“SWING YOU BUM!!!!!!” But, unlike baseball, there are no called strikes in investing.***

John Wooden: “Control emotion or emotion will control you.”

Buffett, 2013 Shareholder Letter: “With my two small investments, I thought only of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field—not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.”

Solution:

1. Avoid Looking at Stock Quotes During Market Hours
2. Avoid Making Investment Decisions During Market Hours
3. Shut Out Extraneous “Noise” by Devoting 90%+ of Time to Reviewing SEC Filings



## Investment versus Speculation

What the Typical Hedge Fund Manager Looks At All Day...



Note the bright colors, flashing lights, graphs and charts – meant to excite, stimulate → PROMOTES ACTION BASED ON EMOTIONS (GAMBLING INSTINCT)



## Investment versus Speculation

What Seven Corners' Chief Investment Officer Looks At All Day...

Consolidated Statements of Cash Flows  
(Unaudited)  
(Dollars in thousands)

	Six Months Ended June 30,	
	2015	2014
<b>Cash flows from operating activities:</b>		
Net (loss) income	\$ (81,530)	\$ 60,621
<b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b>		
Depreciation	4,394	2,014
Amortization	54,108	15,532
Goodwill and intangible assets impairment	156,801	—
Equity-based compensation	9,168	18,683
Deferred income taxes	(62,040)	3,668
Loss/(gain) on the sale of available-for-sale securities	369	(171)
Change in fair value of contingent and deferred consideration	(50,367)	163
Gain on derivative contracts	(56,393)	(58,452)
Deferred compensation plan investments, net	(864)	135
Forgiveness of notes receivable	4,124	2,507
Change in fair value of trading securities	576	(908)
Deferred financing fees amortization	6,178	1,280
Other	(213)	(36)
<b>Increase (decrease) resulting from changes in:</b>		
Cash and securities segregated under federal and other regulations	(43)	2,000
Trading securities	5,190	(301)
Accounts receivable:		
Due from related parties	11,855	31,018
Due from non-related parties	(13,792)	(32,521)
Prepaid expenses and other assets	5,902	(2,372)
Notes receivable	(10,294)	(7,160)
Payable to customers	8,932	(6,588)
Commissions payable	11,261	36,117
Accrued expenses and accounts payable:		
Due to related parties	(632)	(2,629)
Due to non-related parties	17,544	(16,048)
Other liabilities	4,380	(77,161)
Payment of contingent consideration in excess of acquisition date fair value	(2,680)	(18)
Net cash provided by (used in) operating activities	21,934	(30,627)

Monotonous, few colors, no charts  
➔ PROMOTES RATIONAL DECISION-MAKING, NO RUSH TO ACT



## Investment versus Speculation

### Mr. Market Analogy

Berkshire Hathaway 1987 Shareholder Letter:

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his. **Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems.** At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. **Transactions are strictly at your option. Under these conditions, the more manic depressive his behavior, the better for you.**

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: **Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, but it will be disastrous if you fall under his influence.** Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy."



## Investment versus Speculation

Passive > Active

### Berkshire Hathaway 1991 Shareholder Letter:

“As usual [our portfolio] reflects our Rip Van Winkle approach to investing. Guinness is a new position. But we held the other seven stocks a year ago (making allowance for the conversion of our Gillette position from preferred to common) and in six of those we hold an unchanged number of shares. The exception is Federal Home Loan Mortgage (“Freddie Mac”), in which our shareholdings increased slightly. Our stay-put behavior reflects our view that the stock market serves as a relocation center at which money is moved from the active to the patient.”

### Berkshire Hathaway 1996 Shareholder Letter:

“Our portfolio shows little change: We continue to make more money when snoring than when active. Inactivity strikes us as intelligent behavior. Neither we nor most business managers would dream of feverishly trading highly-profitable subsidiaries because a small move in the Federal Reserve's discount rate was predicted or because some Wall Street pundit had reversed his views on the market. Why, then, should we behave differently with our minority positions in wonderful businesses? The art of investing in public companies successfully is little different from the art of successfully acquiring subsidiaries. In each case you simply want to acquire, at a sensible price, a business with excellent economics and able, honest management. Thereafter, you need only monitor whether these qualities are being preserved.”



## Process and Incentives

Process Determines How Broad a Net the Investment Manager Will Cast

Process Determines How To Prioritize Available Investment Opportunities

Process Determines How Rigorously Each Opportunity Will Be Examined

Incentives Determine How Faithfully The Manager Will Adhere to the Process

Incentives Determine How Hard The Investment Manager Will Work

Incentives Determine How Much Pain the Manager Suffers for Bad Performance

Combine the Right Process with the Right Incentives...



## Process and Incentives

...And You Get the Right Result:

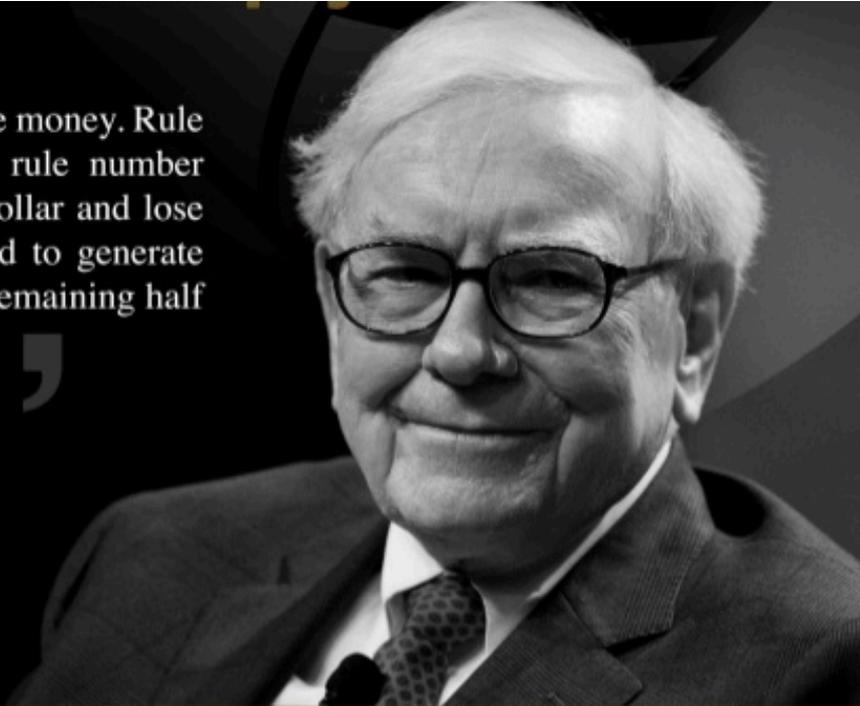




## Investment Process

Rules #1 and #2: See Below

“ Rule No.1 is never lose money. Rule No.2 is never forget rule number one. If you invest 1 dollar and lose 50 cent, you will need to generate 100% return on your remaining half just to break even. ”





## Investment Process

### Rule #3: Always Complete Due Diligence Before Buying

In order to minimize flight accidents, a pilot will follow a standard checklist that looks something like this



Why shouldn't an investment manager similarly follow a detailed checklist meant to minimize the chance of unforced errors in making his or her investment decisions?

APPROVED B-17F and G CHECKLIST	
REVISED 3-1-44	
PILOT'S DUTIES IN RED	
COPILOT'S DUTIES IN BLACK	
<b>BEFORE STARTING</b>	<b>ENGINE RUN-UP</b>
1. Pilot's Preflight—COMPLETE	1. Brakes—Locked
2. Form 1A—CHECKED	2. Trim Tabs—SET
3. Controls and Seats—CHECKED	3. Exercise Turbos and Props
4. Fuel Transfer Valves & Switch—OFF	4. Check Generators—CHECKED & OFF
5. Intercoolers—Cold	5. Run up Engines
6. Gyros—UNCAGED	<b>BEFORE TAKEOFF</b>
7. Fuel Shut-off Switches—OPEN	1. Tailwheel—Locked
8. Gear Switch—NEUTRAL	2. Gyro—Set
9. Cowl Flaps—Open Right— OPEN LEFT—Locked	3. Generators—ON
10. Turbos—OFF	<b>AFTER TAKEOFF</b>
11. Idle cut-off—CHECKED	1. Wheel—PILOT'S SIGNAL
12. Throttles—CLOSED	2. Power Reduction
13. High RPM—CHECKED	3. Cowl Flaps
14. Autopilot—OFF	4. Wheel Check—OK right—OK LEFT
15. De-icers and Anti-icers, Wing and Prop—OFF	<b>BEFORE LANDING</b>
16. Cabin Heat—OFF	1. Radio Call, Altimeter—SET
17. Generators—OFF	2. Crew Positions—OK
<b>STARTING ENGINES</b>	3. Autopilot—OFF
1. Fire Guard and Call Clear—LEFT Right	4. Booster Pumps—On
2. Master Switch—ON	5. Mixture Controls—AUTO-RICH
3. Battery switches and Inverters—ON & CHECKED	6. Intercooler—Set
4. Parking Brakes—Hydraulic Check—On— CHECKED	7. Carburetor Filters—Open
5. Booster Pumps—Pressure—ON & CHECKED	8. Wing De-icers—OFF
6. Carburetor Filters—Open	9. Landing Gear
7. Fuel Quantity—Gallons per tank	a. Visual—Down Right—DOWN LEFT
8. Start Engines; both magnetos on after one revolution	Tailwheel Down, Antenna In, Ball Turret Checked
9. Flight Indicator & Vacuum Pressure CHECKED	b. Light—OK
10. Radio—On	c. Switch OFF—Neutral
11. Check Instruments—CHECKED	10. Hydraulic Pressure—OK Valve closed
12. Crew Report	11. RPM 2100—Set
13. Radio Call & Altimeter—SET	12. Turbos—Set
	13. Flaps $\frac{1}{2}$ —Down
	<b>FINAL APPROACH</b>
	14. Flaps—PILOT'S SIGNAL
	15. RPM 2200—PILOT'S SIGNAL



## Investment Process

### The Seven Corners Process Checklist

1. Maximize potential investment opportunities by reviewing a large number of new investments each week (“DD Round 1”)
2. Narrow the large pool down to a manageable number of potential actionable investments to conduct further due diligence on (“DD Round 2”)
3. Of this narrowed down pool, further narrow the potential actionable investment list to a select few, on which to conduct extensive due diligence (“DD Round 3”)
4. Of these select few, pick the best as actionable investments and identify “buy” target prices upon which to act when reached
5. Deploy capital into best ideas at the right prices.



## Investment Process

### “Round 1” Due Diligence

There are literally thousands of publicly-traded stock and bonds in the United States. The first step in Seven Corners’ due diligence process is to constantly sift through this opportunity set to identify potentially actionable investment opportunities. We source these from the following: The Wall Street Journal, various financial websites, daily financial news summaries and earnings reports, activist investor SEC filings, 52-week low lists, etc. The goal of this process is to systematically identify only the best potential opportunities for further diligence and to ignore the rest.

Every week the investment manager will examine approximately 20 to 30 new securities, or approximately 1000 to 1500 per year. The diligence entails a quick review of the applicable entity’s most recent financials and proxy statement. At the end of each week, the manager will select a handful of these to pass through this initial screen (referred to as “DD Round 1”) to the next step in the diligence process.



## Investment Process

### "Round 2" Due Diligence

Each week, the investment manager will further diligence a handful of the securities that passed the screen in DD Round 1 for the prior week (this is referred to as "DD Round 2"). DD Round 2 entails the following tasks:

- Review in more depth the most recent quarterly and annual financial statements for the entity
- Review in more depth the proxy statement and corporate governance practices of the entity
- Review the entity's most recent earnings press release and/or earnings conference call transcript
- Review general news reports, financial analyses and investor presentations regarding the entity

Of the securities examined in DD Round 2, the manager will select one or two each week to advance to a final round of due diligence (or "DD Round 3").



## Investment Process

### “Round 3” Due Diligence

Each week, the investment manager will conduct more extensive diligence on the security that passed the screen in DD Round 2 for the prior week (this is referred to as “Round 3”). Round 3 entails the following tasks:

- Review the past 5 years’ worth of financial statements for the entity
- Review in detail the most recent quarterly financial statements for the entity
- Review in detail the most recent proxy statement and current corporate governance practices of the entity
- Review the entity’s most recent 8 earnings press releases
- Listen to the entity’s most recent 4 earnings conference calls
- Review general news reports and investor presentations regarding the entity
- Review analyses posted on financial websites regarding the entity and its competitors



## Investment Process

### Final Selection of Investments

Every five weeks, the investment manager aims to select 1 security from the 5 securities that were examined in depth during Round 3 over the prior five weeks as an actionable security. The investment manager will write up the investment thesis regarding this security. The manager will assign each such security a target buy price and a target portfolio size.

If the applicable security thereafter drops below the target price, the manager will establish a position in such security up to the target portfolio size (assuming the underlying thesis remains intact at such time). The target size will normally be between 5% and 10% of the aggregate portfolio, although potentially an exception in extreme circumstances could justify up to a 25% position. The goal of the target price is to insure that the investment is underwritten using a minimum 15% CAGR threshold over the expected holding period.

Once the portfolio has become fully invested, the manager will only allocate capital to new positions to the portfolio if such securities are more attractive on an expected value basis than the existing portfolio holdings using then current prices and circumstances.



## Investment Process

### End Result of the Seven Corners Funneling Process

Over the period of one year, the investment process to be followed by Seven Corners should be expected to produce the following results:

1. 1000 to 1500 different securities will be diligenced in Round 1;
2. 200 to 300 different securities will pass the Round 1 screen and be further diligenced in Round 2;
3. 50 different securities will pass the Round 2 screen and be further diligenced in Round 3;
4. 10 different securities will pass the Round 3 screen and be considered actionable securities for Seven Corners' portfolio; and
5. Up to 10 securities of the original 1000 to 1500 diligenced in Round 1 will be purchased for the portfolio at or below the applicable target prices.



## Investment Process

### Investment Manager's Target Weekly Work Schedule

	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Total Hours
Round 1	2	2	2	2	2	2	0	<b>12</b>
Round 2	4	4	4	4	4	3	0	<b>23</b>
Round 3	5	5	5	5	5	2	0	<b>27</b>
Other	2	2	2	2	2	3	5	<b>18</b>
<b>Total</b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>10</b>	<b>5</b>	<b>80</b>

“Other” entails attending to administrative matters regarding the fund, maintaining Seven Corners’ investment blog, reading the WSJ, Barron’s, general investment websites and daily summaries of market news (Yahoo! Finance’s “In Play” page), checking updated stock and bond quotations, preparing and reviewing investment writeups on potential portfolio selections, selecting which stocks will advance from Round 1 to Round 2, from Round 2 to Round 3, etc.



## Further Information

Seven Corners' services are available to most U.S. individual investors, trusts, small businesses, corporations, pension plans, endowments, family offices, funds of funds, and other institutions. Seven Corners' custodian can support many account types including individual, joint, trust, qualified pension, IRA, and corporate accounts.

Seven Corners may be able to accept clients residing or with primary place of business outside the United States, provided Seven Corners may legally provide investment advice in the client's jurisdiction. In some countries, Seven Corners would be required to register with the securities authorities prior to soliciting clients. Seven Corners' services are not available to persons in those countries except in the event of a preexisting relationship or reverse solicitation. This brochure is not directed to persons in jurisdictions where Seven Corners is not properly registered. Prospective clients from outside the United States should contact Seven Corners for further details.

Seven Corners' investment strategy may not be suitable for all investors. Seven Corners will first discuss your investment objectives and risk tolerance before beginning a new client relationship.

**Should you wish to communicate further with Seven Corners (as a prospective client or otherwise), please use the contact information provided on our website under the heading "Contact". Thanks very much for your interest in our company.**



## LLC Entity Formation

### Entity Details

**THIS IS NOT A STATEMENT OF GOOD STANDING**

<u>File Number:</u>	6114161	<u>Incorporation Date / Formation Date:</u>	8/2/2016 (mm/dd/yyyy)
<u>Entity Name:</u>	SEVEN CORNERS CAPITAL MANAGEMENT, LLC		
<u>Entity Kind:</u>	Limited Liability Company	<u>Entity Type:</u>	General
<u>Residency:</u>	Domestic	State:	DELAWARE

### REGISTERED AGENT INFORMATION

Name:	A REGISTERED AGENT, INC.		
Address:	8 THE GREEN, STE A		
City:	DOVER	County:	Kent
State:	DE	Postal Code:	19901
Phone:	302-288-0670		