

2021 Our 40th Anniversary Year

SANTA MONICA PARTNERS, L.P.
Founded 1982

Tel. 914.833.0958 Fax 914.992.9380
www.smplp.com

October 8, 2021

Dear Partner:

Partners' capital in the third quarter ended September 30, 2021 decreased 1.9% net. In the nine months ended September 30, 2021, partners' capital increased 14.3%. In the first few days of October, stock prices have reversed course substantially and began marching upwards again. So, we are off to a positive start of the fourth quarter. As of the writing of this letter tonight, partners' capital increased 3% for the month raising our year-to-date performance to 17.3%. Actually, volatility is the price of admission to the stock market and matters little to us long-term investors.

There were multiple noteworthy developments in the quarter.

SEC Rule 15c2-11 Shuts Down the Market for "Dark Stocks"

A handful of investors, myself among them for more than six decades, has always sought bargains amongst so-called "dark stocks." These are the securities of companies that either have never gone public through an SEC registration but where private shareholders dribbled shares out into the public marketplace, or companies which have withdrawn their SEC registration and ceased providing statutory financial information with the SEC or OTC Markets. Some have even required an NDA to be signed to receive financial reports including stocks which we own (or have owned) such as Vulcan International Corp. and Sonics & Materials Inc. While some have continued to publish results on their own websites, through wire services, or via old-school snail-mail, many are completely silent and only disclose financial information to existing shareholders upon request. The potential for mispricing is obvious. It is always an exciting moment when I have opened a "Thick Envelope" as I mentioned in a letter to partners in 1991 as follows:

If I ever were to write a book on pink sheet investing, I would have a key chapter entitled, "The Thick Envelope." Receipt of a Thick Envelope is always an exciting event. Most pink sheet companies send shareholders precious little, if any, mail. Maybe an annual financial statement which is on a few thin sheets, folded and fit into a standard 4 1/8 x 9 1/2 business envelope. So, when a large sized 10 x 13 envelope, stuffed thick, arrives in my mail, it brings a smile to my face and a wave of excitement overcomes me and I savor opening it like someone discovering buried treasure.

The Thick Envelope is virtually certain to contain something out of the ordinary, unusual or very special. Always it is good news. Most Thick Envelopes arrive via certified mail.

Of course, when we discover one of these huge bargains which are clearly overlooked or ignored (not infrequently a well-known company such as when we found Manischewitz, Doubleday, and International Speedway), and we see that it is trading at some incredibly low valuation, we get a rush of excitement. These stocks have given us some unbelievable "highs" over the years. For example, we found and invested in International Speedway at around \$1.51 a share and sold it a little over a decade later for more than \$31 a share. Our biggest find ever, Toys R Us, was bought at cents per share and later went on to a 4-digit stock price. Balchem, which we still own, was found in the Pink Sheets at 34 cents a share (adjusting for stock splits) and trades hands around \$146 per share today.

So, what happens now? The rule went into effect September 28th, restricting brokers from publishing proprietary quotes. Most brokers (especially the large ones) have stopped accepting new buy orders for such shares. Moreover, we understand custodians will also enact the same restrictions, so transfer of dark shares will become difficult or perhaps impossible. All dark stocks have fallen to the “Expert Market” or “Grey Market” (the true Wild West of OTC trading). Without the benefit of market makers, execution and price discovery will become virtually impossible or extremely difficult—we just don’t know yet. There are a few brokers who will still accept trades in these stocks (one of which we have opened an account with), as unsolicited orders are still permitted. But the retail investor with an account at Interactive Brokers/Schwab/Fidelity/TD Ameritrade is out of luck and big brokerage firms such as Morgan Stanley and Goldman Sachs will not permit order executions (at least for now). Some professional investors may find a way to transact in stocks of dark companies (using a special broker like the one we found for such cases). The picture looks to be grim so we will have to just be patient to see what, if anything, develops to restart trading in dark company stocks.

We have many thoughts about the entire thing, and you are welcome to contact us to discuss them. There are many very legitimate companies and perhaps thousands of investors owning shares of companies that are being hurt by this “throw out the baby with the bath water” regulation the SEC has instituted. Elimination of the ability of investors owning shares rewards insiders and bad actors. Without public markets for dark companies, you do not have to guess who the only buyers of the market-less stocks will be.

As we are signing off on this letter, the Wall Street Journal today published this article on the subject on how the SEC, the protector of public shareholders, has just done the opposite. <https://www.wsj.com/articles/an-sec-rule-was-meant-to-protect-individual-investors-chaos-ensued-11633705328>

The SEC’s objective in this rule change is to crack down on market manipulation and speculative garbage and, to use the vernacular, plain crap. And these certainly do happen amongst non-reporting stocks. But the SEC is uninterested in or unable to properly address the problem, choosing instead to lay waste with a “burn down the house” approach. Are investors and shareholders being hurt by the public existence of Boston Sand & Gravel with its 100,000 shares outstanding and average daily volume of approximately zero? <https://www.bostonsand.com/> Are they being hurt by Hershey Creamery, <http://www.hersheyicecream.com/> or Reo Plastics? <https://www.reoplastics.com/>. If all the numerous stocks were a blighted block in an otherwise modern city, only that block might need demolition. But the SEC’s chosen solution is not to make a case-by-case examination, but rather to bulldoze the entire field of dark stocks which is clearly a pigheaded, darn wrong, and unfair approach to have taken.

If there is any silver lining here at all, it is that the rule change has spurred some of the more shareholder-friendly dark companies to be forthcoming and current, releasing their financials publicly to OTC Markets. Initio Inc (INTO) a tiny company with cash, blue chip stocks, and no liabilities to speak of (and few shares in public hands) has up-listed from the “Pink-No Information” tier to “Pink-Limited Information”. Many investors are seeing the financial results of companies such as INTO for the very first time. This new sunlight should lead to greater interest, increased trading volume, and higher valuations.

Here are several other interesting companies that have recently released (or will soon release) their financial information to the world.

J. G. Boswell (BWEL) – This rather solid 94-year-old California agricultural company grows tomatoes that are processed into paste and farms cotton, fruits, and livestock. It also has water, oil & gas, and mineral rights. It is a substantial company with close to \$1 billion of inflation-resistant, irreplaceable assets assembled in the last century. Its business performance is cyclical and not easily predictable. It is consistent in its low return on capital. One has to wonder why management remains in place. The company has never been shareholder friendly to outsiders. It's tough to imagine a more inflation-proof collection. On the negative side, the company's results are unpredictable and cyclical, and it rarely earns an attractive cash return on its invested capital. Despite publishing its financials, the company remains rather inscrutable to investors and does not seem interested in changing.

<https://boswelltomatoes.com/>

<https://realmoney.thestreet.com/investing/jg-boswell-marches-to-the-beat-of-its-own-drummer-15365196>.

National Stockyards (NSYC) – This thinly traded stockyard was founded in 1873 and sold over 430,000 head of cattle in 2020, earning a healthy profit in the process. The company also owns 84 acres of St. Louis real estate, which it is selling off gradually at prices well over book value.

<https://www.onsy.com/>

<http://www.oddballstocks.com/2017/04/another-look-at-national-stock-yards.html>

Merchants National Properties (MNPP) – Incorporated in 1928, MNPP acquired its first seventeen properties that year for \$3,523,400. Today, MNPP is involved in all phases of real estate management, development, and leasing. MNPP properties are located principally in the Northeast and Mid-Atlantic states, concentrated in New York, and include office buildings, retail, and other commercial real estate. Its 91,737 shares are very closely held and trade infrequently. When they do trade, it's usually below book value.

<https://merchantsnationalproperties.com/>

REO Plastics (REOP) – Founded in 1960, this Minnesota-based plastic molder has book value per share of over \$52 and earned \$2.5 million of pre-tax profit (\$5.50 per share) in the fiscal year ending April 2021. Last sale price was \$27 per share.

<https://www.reoplastics.com/>

If interested, this grid from OTC Markets shows the various levels of OTC stocks and where they will trade depending on the information provided. Many dark stocks will trade in the “Expert” and “Grey” markets while some (like those mentioned above) will move to “Pink Limited” or better. [15c2-11 Tier Chart.pdf \(otcmarkets.com\)](#)

Investment Updates

Sonics and Materials, Inc. (SIMA)

In October 2018, we wrote to you about a stock we found which we researched and began to invest in. It appeared to be quite attractive because it was financially extremely strong, highly profitable, growing slowly but steadily, and was clearly undervalued probably due to not being registered with the SEC. This is what we wrote:

Let me assure you we are continuing to look for bargains and recently found what we believe is an exceptionally outstanding one. In fact, at this moment in time we would have to say it is unique. You will soon see why we say this. The company was incorporated in 1969 in New Jersey and reincorporated in Delaware in 1978, went

public in 1996 but deregistered and went dark 16 years ago this month, October 2002. They are in the same lines of business they have always been in and there is plenty of information to keep us updated on products and services old and new on its very detailed website and from customers and potential customers we have surveyed. They continue to do business internationally too. Headquarters is not much beyond a stone's throw car ride from our office across a nearby state border. It has some patents of varying value, but its main advantage is it operates in quite a few small niches in which it appears so entrenched that competition is unlikely to want to go after them and customers are very likely to remain sticky loyal. Service is a key factor that is provided very well and feedback attests to that as do low warranty claims. A feature that is both interesting and surprising for a small company is the fact that R&D expenses (not capitalized) are about 10% of sales annually and, as you shall see in a moment, profit margins are still, net of this, double digit. The management is headed by the founder father and his daughter. To describe them as very careful and financially conservative and risk adverse is to understate the meaning of conservative. The balance sheet stats will save me words. We have the audited statement for several past years. An unusual, indeed incredibly undervalued one, unique at this moment in time. This stock has these statistical features.

Key Statistics as of Fiscal Year ended June 30, 2018

	<u>Per Share</u>	<u>Total Dollars</u>
1. Cash	\$6.05	\$20,580,658
2. Working Capital	\$8.68	\$29,517,937
3. Book Value	\$8.06	\$27,414,632
4. EPS	\$0.94 (Vs. \$0.66)	\$ 3,206,682

Our Last Purchase Price was at \$8.00 last week.

5. P/E	8.5x
6. P/BV	0.92x
7. P/Cash	1.32x

Thus, at the highest price we have paid so far, \$8, we got \$6.05 in cash and for \$1.95 we got a whole company with over \$32 million in assets and few liabilities worth mentioning. To date we have only accumulated a small five figure position because although there are 3,400,000 shares outstanding, we estimate no more than 600,000 or less are in the float. It is damn hard to find and to purchase shares. The shares literally trade by appointment, and they do not trade in the OTC Pink which has no information on it. None at all. That at least is helpful to us as it keeps competition away. It is no wonder the shares when available are so cheap. They trade in the grey market. We have some experience and possibly some ideas to try and apply to acquire stock and will seek to do what we can to succeed. Now you will understand why we are leaving the name of this stock out of this letter.

Recently, a "Thick Envelope" arrived in our mailbox with a Bronx telephone sized and weight book in it from Sonics and Materials, Inc (this one less happy than others discussed in years past).

There is a lot we could say about being invested in Sonics, such as having to sign an NDA to receive a copy of the June annual audited report the following November and, in 2019, persuading the President to agree to hold their first annual meeting in decades. She held the meeting on the internet and took only three questions (none of which could be submitted beforehand) before closing the meeting promptly. During the 2020 meeting, she answered only one inconsequential question and closed the meeting.

She did, however, take our telephone call after the meeting and fielded many of our questions. She made very clear she had no idea what to do with the growing hoard of cash, which was the prime asset on the balance sheet and was equal to \$8.58 per share (making up most of the share price) at the time and most certainly amounts to more now. She also made clear she expected her two sons (who were in college at the time) to come into the company one day and eventually succeed both herself (she is in her fifties) and her 80-year-old father, the company founder.

Since obtaining a position starting at \$7 in 2018, the stock ran up as high as \$13+ and then for no particular reason fell to \$6 bid but could not be bought there. The Thick Envelope brought news that the controlling father and daughter were offering to purchase all shares in public hands at a price of \$10 per share. This amounts, in our opinion, to what we know no other or better way to describe other than as a royal screwing of the public shareholders.

Unfortunately, they had us stuck between a rock and a hard place. The \$10 tender was certainly too low; the company is worth more than that, but it is very illiquid and information is tightly guarded. The annual meetings we attended were disappointing to put it mildly. We had such high hopes with that first meeting in so many years, but the controlling insiders just don't care. What can you do?

The price was ridiculous, and no one was around to protect shareholders (we place much of the blame on the new SEC rule discussed above). Sonics did not put out any press release for the tender offer and made no communication about it to the public. The SEC does not care since they allowed SIMA to de-register and disappear many years ago
<http://www.nonamestocks.com/2016/06/the-sec-allows-companies-to-go-dark.html>

With the offer document, the company included historical financials. For fiscal year 2021 we only have nine months of data, so we've taken the liberty of extrapolating that out to the full year (the far-left column is our linear estimate).

What do you think this stock is worth? We'll go with \$15 at least.

<i>USD millions</i>	2021 (est)	2021 (9 mo)	2020	2019	2018	2017	2016	2015	2014
Book value	35.78	35.12	33.13	32.02	29.52	26.39	24.31	21.89	19.84
Cash	30.83	29.19	24.25	23.03	20.58	17.84	16.73	13.52	11.23
Net income	2.65	1.99	1.12	2.50	3.21	2.24	2.19	2.09	2.01
Revenue	24.67	18.51	19.40	21.75	22.96	22.19	20.50	20.00	20.37
Shares	3.40	3.40	3.40	3.40	3.40	3.40	3.40	3.40	3.41
Per share									
BVPS	10.52	10.33	9.74	9.42	8.68	7.76	7.15	6.44	5.82
Cash	9.07	8.58	7.13	6.77	6.05	5.25	4.92	3.98	3.29
EPS	0.78	0.58	0.33	0.74	0.94	0.66	0.64	0.61	0.59
Revenue	7.26	5.44	5.71	6.40	6.75	6.53	6.03	5.88	5.97
Annual growth									
Book value	8.0%	n/a	3.5%	8.5%	11.9%	8.6%	11.2%	10.3%	n/a
Cash	27.1%	n/a	5.3%	11.9%	15.4%	6.6%	23.7%	20.4%	n/a
Net income	137.6%	n/a	-55.4%	-22.1%	43.3%	2.3%	4.9%	4.0%	n/a
Revenue	27.2%	n/a	-10.8%	-5.3%	3.5%	8.2%	2.5%	-1.8%	n/a

Access Value, the firm that provided the so-called "fair value opinion", determined that the fair market value per share of Common Stock as of March 31, 2021 was \$6.11 on a

minority, non-marketable basis and \$9.60 on a minority, marketable basis. Unbelievable! The company has \$8.58 per share in cash and securities right now and earned \$0.58 the past 9 months yet it's worth \$6.11 to \$9.60?!?!

But what can be done? If you owned shares your choice was either take the money or continue waiting. We wouldn't count on the company treating us (or anyone else) well. We surrendered after consulting lawyers and determining there was not a thing we could do, decided to c'est la vie, move on, and tendered our shares. Should you be interested, we can email a copy of the hundred- and four-page tender offer document.

The simple truth of the matter is that the controlling family has successfully squeezed out most of the minority shareholders at a low-ball price enriching themselves and leaving others out in the cold to kick rocks. We made a small profit on the entire roughly three-year experience but could have earned a significantly better return had we as minority shareholders been treated fairly.

Texas Pacific Land Corporation (TPL)

We have many times in past letters discussed our investment in TPL; below are useful refreshers.

From Q1 2018:

In the quarter a significant move we made was to increase our investment in Texas Pacific Land Trust which has now become our third eight figure investment in market value (seven figures in terms of cost) behind Balchem and Mastercard. We first made an investment in TPL in 2005, when we purchased 4,676 shares at \$29.957 (less than \$141,000 and presently worth over \$2.9 million). We did not buy any more until eight years later, in 2013 when it had more than tripled and we paid \$96.60 for 2,000 additional shares. In 2016, 2017 and 2018, we became aware of the company's prospects very substantially improving and we purchased thousands more shares in the mid \$250's and bought still more in the \$350 range during 2017 as we learned yet more about prospects for the years ahead. In the first quarter we added still more shares just over \$500 per share as our confidence about the future has continued to grow. Our major position is now almost 18,000 shares and TPL is priced tonight at \$620.24.

From Q1 2021:

Texas Pacific Land Trust (TPL) about which we have written a fair amount, after 133 years and a "kick in the rear" from Murray Stahl and Eric Oliver and far too many millions spent in a proxy battle, all paid by the Trust last year, completed a reorganization and became a "C" corporation renamed Texas Pacific Land Corporation on January 11, 2021 and immediately rose on that day \$68.50 per share to \$869.50. Mind you Rip Van Winkle TPL awoke from great slumber in February and soared in March. TPL closed on December 31, 2020 at \$727.00-- which was not too shabby given it proceeded to trade higher on each of 40 of the next 60 trading days in the first quarter. Less than three months later, on March 17th, I suppose with the luck of the Irish on St. Patrick's Day as a tailwind, the shares reached an all-time high to date of \$1,710.50 almost \$1,000 higher and a year-to-date gain of 137%.

Things were going swimmingly for the shares as many institutional investors were introduced to the stock for the first time (their "mandates" happy to buy stock in a corporation but not a trust), and, with the potential to now be placed in an index, all looked rosy for TPL shares.

Operationally, however, we noticed the company's margins have been dropping largely due to added expenses at corporate headquarters consisting of increased employees, salaries, and a fancy new office among other things. We have repeatedly expressed our displeasure with these completely unnecessary expenses in private with the company and other shareholders. A recent report from Credit Suisse publicly highlighted the declining margins and slapped an \$800 price target with a SELL rating for TPL (CFRA also discussed the declining margins in a recent report but maintains a HOLD recommendation for the stock). The result of all of this has been a decline in TPL's shares of over 30% from \$1,750 in May to \$1,209.36 as of the end of this quarter to \$1,185.88 last night.

The Credit Suisse report is factual, but in our opinion the analyst is missing a full understanding of TPL and offered no analysis or explanation of what has caused the margin decrease, and he completely overlooked the unique tremendous assets TPL possesses. Neither did he consider the possibility that a majority of shareholders might in fact demand the added overhead be eliminated as all of it, with the exception of that related to the water business, is unnecessary. TPL is not an oil company, it is a royalty company.

Shareholder resolutions for the first ever annual meeting scheduled for November 16th were submitted to the company for its just issued proxy. https://www.sec.gov/Archives/edgar/data/0001811074/000110465921122328/tm2129101d2_defa14a.htm One was to have as a goal a 95% gross profit margin. The other was to institute a share buyback of 1% of the outstanding shares in each of the next two years. Inexplicably, the SEC has allowed the company to disregard the proposals. We think it likely management will receive a negative (withhold) vote on its seven proposals. This will send a message of shareholder sentiment towards management, although in no way binding. We believe margins can be raised significantly and that cash flow and cash on hand, soon to be \$400 million, above dividend payment requirements at the quarterly rate of \$2.75, for an annualized rate of \$11 per share, should be applied to stock repurchases. We are also exploring avenues for accomplishing this and more.

A New Name

In July we began buying shares in Tejon Ranch Co. (TRC), one of the largest landowners in Southern California. The company owns 270,000 acres of contiguous, largely undeveloped land that, at its furthest south border, is 60 miles north of downtown Los Angeles and, at its northmost point, is 15 miles east of Bakersfield.

Interstate-5 (I-5), which runs through the US from Canada to Mexico, cuts through the property in one of the most heavily trafficked sections of freeway in the country. The Tejon Ranch Commerce Center (TRCC), visited by the plethora of tourists, truckers, and other travelers venturing between Northern and Southern California, is one of the busiest stops in the nation.

Much like TPL was when we first bought it, TRC is an underdeveloped land company rich with inflation-resistant assets, few liabilities, and great potential. The current market value of less than \$500 million is extremely undemanding in our view and gives little appreciation for the true worth of the company's irreplaceable assets. We believe TRC's travel center, commercial, industrial, power plant, cell tower, oil and gas royalty, water, farm, and residential assets are collectively worth over \$1 billion on a conservative basis, and potentially much more.

The big question is *when* these assets will be developed and monetized and therefore when the stock market will give credit for the intrinsic underlying value. We have seen the shares of other land companies explode on news of development and monetization (TPL and St. Joe Co. for example). We are, of course, patient long-term investors and are fully aware that the

value of TRC may take decades to out itself. We are also aware of other likeminded buyers interested in spurring action so as to see results sooner rather than later. We would love to find a strategic investor(s) to join us so we ask that you please feel free to contact us if interested.

We have a deck prepared by our colleague, David Spier, outlining why the company is worth multiples more than it's selling for, which we would be happy to share.

Portfolio Turnover

Since our inception in 1982 we have always employed a strategy aimed at low portfolio turnover, which has over the decades saved us millions of dollars in taxes, commissions, and other frictional fees. Buy-and-hold has worked well for us and many other long-term investors, and we think it works particularly well in inflationary environments (as many "experts" think we may be entering). In periods of rising prices, investors may show nominal gains but real losses after factoring into account inflation, transaction fees, and taxes.

If, for example, an investor earns a 15% pre-tax compounded annual return over a decade in which there is 10% annual inflation and does so by trading in and out of stocks and therefore paying a 37% short-term capital gains tax on all profits (to say nothing of state and/or city taxes), then their *real* return becomes a *negative* 1% per year after taxes (ignoring transaction fees). If, on the other hand, the investor can achieve the same 15% with the same inflationary assumptions using a buy-and-hold approach and therefore only paying long-term 20% capital gains tax at the end of the decade, their real return will be a *positive* 4% per annum. We do not make macroeconomic forecasts, but we do have a strong concern that inflation could become rampant. We *do* aim to position our portfolio to handle many possible versions of the future including that of high inflation.

We have always preferred to water our flowers and cut our weeds as opposed to vice versa which is what virtually all other portfolio managers do. Of course, we may trim a flower (if we find a better one) or trade a weed (if it's cheap enough). Investing is, after all, a game of opportunity costs. A slimy cigar butt at 2x earnings may be more attractive than a beautiful flower at 50x. Price and value are forever fluctuating, and it is our job to determine the best bets we can make (getting as much value for as little a price) taking all factors into account. That said, it is and always will be our default to err on the side of inaction, letting our businesses grow in value without unnecessary interruption.

To assist you with tax planning, we would like to let you know that we have harvested some long-term gains amounting to \$5.9 million this year. This is more than ever in our almost 40-year history and is merely about eight percent of total capital. We will make arrangements to provide your share of the gains if you require that information before year end.

As always if you have any comments or questions, we welcome hearing from you.

Warmly,



Lawrence J. Goldstein



Joseph K. Raymond