

2022 Our 41<sup>st</sup> Anniversary Year

**SANTA MONICA PARTNERS, L.P.**  
Founded 1982

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October 5, 2022

Dear Partner:

Partners' capital in the third quarter ended September 30, 2022 decreased 1.3% net. In the nine months ended September 30, 2022, partners' capital decreased 16.4% net. Our losses have been less than those of the indexes. This is not an excuse or justification but simply a statement of the facts.

	<b>9 MONTHS ENDED 9/30/22 WITH DIVIDENDS</b>
DJIA	-19.7%
S&P 500	-23.9%
NASDAQ COMPOSITE	-32.0%
RUSSELL 2000	-25.1%
RUSSELL MICROCAP	-25.5%
S&P 600 SMALL CAP	-23.2%
<b>SANTA MONICA PARTNERS, L.P.</b>	<b>-16.4%</b>

We are of course in the business of making money over the long run and have done so successfully for over 40 years now. We don't like reporting short-term declines, but we consider downward volatility normal and don't let it interfere with our long-term outlook.

That the markets can turn on a dime so to speak is quite obvious. As this letter is mailed three trading days after the close of the quarter, our portfolio has grown 6.4% since September 30th and is now down for the year 11.1%.

**Our Belief That Length of Stay Contributes to Performance**

Most market commentators focus on the selection of individual securities by funds or portfolio managers. We are uncomfortable with crowded fields or markets. Remember our trademark is *Stocks Overlooked or Ignored by Otherwise Intelligent Investors*®.

Reviewing fund management records will impress you that a large portion of the very successful records were produced by holding securities and other relationships for many years. The prime example used by most is the record of Warren Buffett (WB) which has been better than 20% a year for over 50 years.

Holdings held 30 or more years have produced remarkably good performance, with some securities hitting hundreds and even thousands of percent or more appreciation versus original cost. These gains were achieved by careful initial selection and

maintenance of the positions, and reinvesting distributions over long periods of time. This shows the power of uninterrupted compounding of retained earnings.

Speaking of Buffett, he (through Berkshire Hathaway) has acquired a large position in Occidental Petroleum (OXY) which “experts” think will grow less than 10% compounded in the next five years. We hold Texas Pacific Land (TPL), a major Permian Basin landowner and lessor of properties to oil and gas drillers and water supplier as well. OXY is the largest acreage holder and a leading producer in the Permian Basin, with assets concentrated in West Texas and Southeast New Mexico.

I feel it is worth mentioning in the last 17 years since we first invested in it, our TPL has compounded at 31% annually (excluding dividends which add a couple percent). If OXY was a good alternative to Berkshire’s cash position, in our opinion the smaller and somewhat obscure TPL is even better.

We also have an investment in Permian Basin Royalty Trust (PBT) which is a “small” not well-known Permian Basin land owning trust which we believe will soon be doubling its monthly significant dividend payouts. So, both we and Buffett are very important Permian Basin oil landowners, and he (Warren) is in good company, but our small companies have grown much faster than his and should prove to grow their profits and stock price at a pace which should run rings around his and continue to be a really wonderful long-term investment. No in and out trading for us or WB.

### **Look for Value WITH (Not VS) Growth**

Investment theory is based on fair value being the price a knowledgeable buyer would pay for a business. Therefore, one should invest when a stock trades at a discount to fair value.

A so-called “value investor” seeks a position in a stock selling below the value of a company’s assets or normalized earnings. The elapsed time is usually small and is often dependent on an economic cycle or commodity price change to instigate a multiple re-rating. Most value investors expect this to occur within something like five years. Once full value is realized, the value investor will look to recycle profits into other undervalued opportunities.

Typically, a “growth investor” has a different mathematical approach. Growth often infers a decline in the price a company sells its products or services as demand grows. This could take many years. When DuPont viewed itself as a growth company it was willing to build an expensive chemical plant to develop the market for its products. It was willing to wait 20 years to reach an overall breakeven level, and it expected to be very profitable in the years following. Remember the phrase “better living through chemistry,” which began life in 1935 as part of a DuPont advertising slogan? It was a wonderful stock until it accumulated some baggage over the course of the 20th century and ended its great growth history.

Nothing is for sure or permanent of course, but we do see many reasons to believe TPL will continue to be a great grower and couldn’t be more pleased to see that WB believes in the solid growth in store for the Permian Basin. Incidentally, WB wrote a letter to me recently mentioning he bought 100 shares of TPL when he was 13 years old and he still has them. As a result of the stock splits, he should have 3,000 shares

today. Unfortunately, he never bought any more in Berkshire and for that we can only be grateful because he might've bought the whole shooting match lock stock and barrel if he kept his eye on that "ball." Now you know a secret about TPL and Buffett investing in it but not following up on his teeny tiny purchase a long time ago.

Value investors often have a relatively shorter length-of-stay than growth investors. Most investors able to earn many multiples of their initial investment in a security have tended to be growth oriented. We, however, have experience buying "value" which very often has been in "growth" businesses at bargain prices generally because they were too small, too closely held, too inactively traded, too this and too that etc. etc. They were out of the limelight until they were in it. Our very best historical value/growth investment being Balchem which the *Wall Street Journal* called "the best stock you never heard of" and went from 24 cents to \$172 last November.

The dream investment is and always will be the deeply undervalued company with excellent growth and return prospects ahead of it. These kinds of investments don't grow on trees, but they don't need to. Capturing a few (like Balchem, Mastercard, and TPL, for example), is enough to earn a solid return on investment over decades. We are always looking to find and add more of these gems to our portfolio.

### **Inflation, Recession, and Other Worries**

We recently had the pleasure of listening to our brilliant friend Murray Stahl opine for nearly four hours on various subjects including that of inflation and the Fed's raising of interest rates.

Murray astutely pointed out that over 40% of U.S. GNP comes from areas where demand is somewhat decoupled from general economic conditions, such as healthcare, government, and utilities. Rising interest rates will have little impact on the demand in these sectors which won't help curb price inflation. Will government expenditures decrease? Will medical conditions go untreated? Will people use less energy? Maybe on the fringes, but by and large demand from these areas is durable and persistent. In fact, rising rates could possibly make inflation worse as the entities that service these areas may need to raise prices to pay their increased interest expense.

Higher interest rates are largely credited with reducing the inflation of the 1970s, but the impact of labor supply from China and new commodity supply from Russia and other emerging nations is rarely considered. China exported very cheap labor and Russia has been exporting important commodities in significant quantities—both once were deflationary factors. Today, interest rate hikes are being attempted in isolation, with the very labor and commodity dynamics changed.

Many market participants and commentators think rapid rate increases will throw the world into recession. We don't know if this will be the case or not, but we will make a simple and (we think) useful observation.

Much like co-evolutionary biology, it is the nature of capitalism that all companies are partaking in a constant struggle for survival. On the African savanna, each gazelle must run faster than the slowest gazelle to avoid being eaten by the lion. The lion must run faster than the slowest gazelle to avoid starvation. Given natural selection

and “survival of the fittest,” the gazelles and lions are in a constant race to improve their speed. Importantly, no matter who you are—gazelle or lion—when the sun comes up you better be running.

The same is true for companies; they are all in a fight for profits. The “fittest” companies enjoy outsized returns. The sluggish ones go out of business.

Interestingly, tough economic times can cause certain companies to stop running and instead walk or perhaps even begin backpedaling. This is usually due to some combination of debt, soft demand, and a bloated/bureaucratic cost structure. This presents a huge opportunity for those lean, financially strong companies to make major gains against weaker peers.

Imagine if you were a lion and all the gazelles in your territory could no longer run—they could only walk or stand still. It would be a dream! Breakfast, lunch, and dinner without so much as breaking stride or sweat.

It’s no different in industry. Strong companies salivate when their weaker competitors announce major layoffs and scrap expansion plans. What better way to make comparative gains than when others are reeling? It may be harsh, but it’s true. Mother Nature makes sure of it.

We trust you know we have always favored companies with strong balance sheets, durable demand, wide margins, strong returns, lean cost structures, able management, and long-term views. These are exactly the kinds of companies that should do well during and after periods of distress, filling the vacancies left by their weaker counterparts.

As we have said many, many times when downturns have occurred, as day follows night, expansion follows contraction. This is a normal, cyclical process. If we don’t have to sell anything, we’re not really “losing” money. Like pruning a shrub, it may be smaller at the beginning of the next season, but it will come back healthier and stronger as a result. This process takes time.

A little over a year ago in our July 6, 2021 letter to partners we wrote a section on “The Key Organ in Investing.” We encourage you to go back and re-read this section. The concluding sentence states, “We thank you for your strong stomach and encourage the same response when the next panic (inevitably) strikes.”

Well, it only took about 15 months for some new panic (inflation, rising rates, and a “bear market”) to set in. Such is the nature of investing in stocks. We will ride out this period of turbulence like all those that have come before—with calmness and a long-term view.

Attached is a refresher on our “Philosophy and Approach” taken from our website [smplp.com](http://smplp.com). We think it useful for partners to revisit our core tenets, especially during periods of market volatility.

Should you have any questions or comments please do let us know.

Warmly,



Lawrence J. Goldstein



Joseph K. Raymond

P.S. Warren Buffett observed his 92nd birthday a few weeks ago. A legendary Investor and Philanthropist, someone assembled a list of some 36 of his powerful quotes. He reads more than 12 hours a day, and at his age he still invests for the long-term only. His life is a role model to many. We thought it might be helpful in getting through this rocky market period. Note particularly numbers 20 and 25.

1. The best investment you can make, is an investment in yourself... The more you learn, the more you'll earn.
2. If you don't find a way to make money while you sleep, you will work until you die.
3. It takes 20 years to build a reputation and five minutes to ruin it. If you think about that you'll do things differently.
4. Life is like a snowball. The important thing is finding wet snow and a really long hill.
5. I will tell you how to become rich. Close the doors. *Be fearful when others are greedy. Be greedy when others are fearful.*
6. We don't have to be smarter than the rest. We have to be more disciplined than the rest.
7. My life has been a product of compound interest. Nothing more. Nothing less. And nothing brilliant.
8. Lose money for the firm, and I will be understanding; lose a shred of reputation for the firm, and I will be ruthless.
9. Rule No.1 is never lose money. Rule No.2 is never forget Rule No.1.
10. The chains of habit are too light to be felt until they are too heavy to be broken.
11. Time is the friend of the wonderful company, the enemy of the mediocre.
12. Only when the tide goes out do you discover who's been swimming naked.

13. Someone is sitting in the shade today because someone planted a tree a long time ago.
14. The difference between successful people and really successful people is that really successful people say 'No' to almost everything.
15. You only have to do a very few things right in your life so long as you don't do too many things wrong.
16. Never invest in a business you cannot understand.
17. It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.
18. Honesty is a very expensive gift, don't expect it from cheap people.
19. Don't ask a barber whether you need a haircut.
20. Our favorite holding period is forever.
21. Choosing your heroes is very important. Associate well, marry up and hope you find someone who doesn't mind marrying down.
22. As a billionaire, most people are interested in what type of cars I drive, instead of asking me what types of books gave me the drive to be successful.
23. Price is what you pay, value is what you get.
24. The investor of today does not profit from yesterday's growth.
25. The stock market is designed to transfer money from the active to the patient.
26. If a business does well, the stock eventually follows.
27. On taking Risk - Never test the depth of the river with both feet.
28. On Earnings - Never depend on Single income. Make Investment to create second source of income.
29. On Spending - If you buy things you do not need, soon you have to sell things you need.
30. On Savings - Do not save what is left after spending, but spend what is left after saving.
31. On Investment - Do not put all eggs in one basket.
32. Tell me who your heroes are and I will tell you who you will turn out to be.
33. If you cannot control your emotions, you cannot control your money.

34. Successful investing takes time, discipline and patience. No matter how great the talent or effort, some things just take time. You can't produce a baby in one month by getting nine women pregnant.
35. The one easy way to become worth 50 percent more than you are now — at least — is to hone your communication skills — both written and verbal... if you can't communicate, it's like winking at a girl in the dark — nothing happens. You can have all the brainpower in the world, but you have to be able to transmit it.
36. Read 500 pages like this every day. That's how knowledge works. It builds up, like compound interest. All of you can do it, but I guarantee not many of you will do it.

## **Santa Monica Partners Philosophy and Approach**

### **Overlooked or Ignored Market**

Companies often suffer from neglect for many reasons. Some have few shares outstanding or are closely held. Others lack liquidity, trade in inefficient markets or in very low volume. Many have market capitalizations so small they fail to appear on professional investor radar screens.

Professional investors generally look for companies of much larger size and require a high degree of liquidity. They are willing to accept symmetrical risk. We, on the other hand, seek out neglected, asymmetrical investments and are able to find undiscovered value. By investing for the long-term, we seek to avoid conventional market volatility and high risk.

Because we have spent more than six decades researching companies that trade in neglected markets, we have more experience than most in identifying financially strong companies whose value has yet to be recognized.

It is important to understand why it is that many stocks trade in misunderstood or neglected markets (Over The Counter, NASDAQ Bulletin Board, "Pink Sheets", and even, at times, the NYSE) and often trade at significant discounts to comparable, more liquid stocks listed on the major stock exchanges. The answer lies in the fact that there is very little analyst coverage, little notoriety, and less readily available information available to the average investor. This translates into larger discounts from real or intrinsic value, thus presenting a simple, yet genuine investment opportunity.

### **Our Research**

Before making any investment, we strive to perform an exhaustive fundamental analysis and appraise the value of each company component. We methodically educate ourselves on a company's industry, financial position, competition, suppliers, customers, management, and opportunities. We seek to explore all facts available to an outsider. We develop a close and enduring rapport with corporate leaders and maintain direct access to them. We expect to regularly visit with management and directors and speak frequently with customers, suppliers, distributors, competitors and employees. We try to understand the wants, needs, aims, goals, desires and ethical standards of the company's leader, in whose image the company is usually created. This understanding enables us to be comfortable holding investments during turbulent times and setbacks without questioning our beliefs.

### **Investment Characteristics**

Common threads running through many of our investments at time of initial purchase include:

- Cash rich and debt-free
- Substantial free cash flow
- High return on equity
- Above average profit margins
- Earnings growth
- Share buybacks

- Low P/E ratio; occasionally as low as 2, 3 or 4
- Discount to tangible net worth
- Market price below current assets less all liabilities
- Sometimes trading at less than cash per share

Many companies have a high intrinsic value hidden behind a low share price. People often tend to judge a company by its market price, similar to the way one judges a book by its cover. Often, investors will assume that because a stock is trading at \$5 or \$10 dollars per share, it is a speculative investment with significant risk. Moreover, should a company's stock sell below \$1 per share, most will assume it to be highly speculative, insignificant and not worth their time. While this may be true at times, our performance record and analytics shows this to be an incorrect generalization, often far from the truth.

### **Why These Characteristics**

Since 1982, Santa Monica Partners has focused on companies with the following fundamental characteristics. Most have proven their value over time. The conventional wisdom is to avoid companies with these characteristics, but the fact is, and our experience shows, that patience will be rewarded and eventually value will out.

### **Thinly Traded with Few Shares Outstanding**

Because of their inability to take large positions quickly enough to justify their costly research, professional investors often overlook companies with few shares outstanding. Many are unwilling to devote long periods of time to accumulate positions and generally want the option of liquidating at a moment's notice. We, however, are very willing to take our time to accumulate shares and will even go directly to the holders when appropriate. Moreover, it is our goal to seek out such wonderful companies and most importantly, it is our intention to hold them for a long period of time.

### **Closely Held**

Closely held companies are often led by management teams interested in building and maximizing long-term shareholder value because they own the company. Murray Stahl, Chairman and founder of both Horizon Kinetics LLC and FRMO Corp., dubbed such companies "Owner-Operated" companies. Such companies without using that descriptive "monica" have always been our preference for investment. In contrast, companies with minimal inside control, where the senior level management receive high salaries, bonuses and lots of stock options. have a greater concern and are often more preoccupied with job security and feathering their own nest at shareholders' expense.

### **Inefficient Markets**

Companies trading in inefficient markets will typically trade at a lower valuation than their peers. This is due in part, to the lack of public information readily available and the absence of analyst coverage; vastly different than the availability and coverage of companies trading in larger, more structured markets.

**Low Trading Volume**

Investors often shy away from companies with low trading volume because of their perceived lack of liquidity. These are the very opportunities that Santa Monica Partners relishes. By investing in companies that are kept out of the spotlight, we are able to purchase stock for a fraction of its real worth. We prefer building a position when it is neither quick, nor easy.

**Liquidity**

Our investments typically experience an event that creates greater liquidity. Whether discovered by analysts, the media or even through our own vice, established, valuable companies are eventually noticed, rise in price and gain liquidity. Many are the subject of significant stock splits that multiply outstanding shares sometimes five, ten or even twenty-fold. Some receive notoriety and offer liquidity through additional offerings or listings on established markets. Still others may be sold or taken over, merge or go private. In each case, the result is a liquidity creating event. Events such as these are not uncommon. In fact, we believe they occur quite frequently —sometimes with a “push” from us.