SOTERRA CAPITAL INVESTMENT PHILOSOPHY

The following reflects the investment philosophy and beliefs of Soterra Capital and its senior executives. Our business is capital allocation, primarily in private markets, wherein we seek to acquire and build strong enduring businesses over long periods of time. From a purely economic perspective, our goal is to compound value at higher rates of return while leveraging our operational background and collective resource to manage risk below what is normally commensurate with the returns earned.

Risk

We could describe our job, and as the job of every for-profit venture in the world, if done correctly, as intelligently bear risk for profit. We see it as paramount for investors and operators not only pay attention to the return produced from a particular investment but also the risk taken to achieve that return. Outcome alone does not prove a decision right or wrong – determining the amount of risk taken to achieve an outcome is just as important, if not more important. We define risk in two ways:

- The likelihood of long-term capital impairment.
- The likelihood of missed opportunity.

Our focus is more on the former than the latter, but in both cases, we are looking to identify the likelihood of most (all) perceivable outcomes and then assess the magnitude of loss when the unfavorable ones do. Contrary to many theorists in the market, that by the above definitions, volatility does not equate to risk, with one key exception: when there is for some reason a short time horizon for liquidity. That can present itself in several forms, most of which put the asset owners in the position of becoming a forced seller. One form of risk that must be addressed is debt. Debt creates event horizons that, if not managed well, expose companies to risks of volatility if there is insufficient liquidity to overcome that volatility. In our view, volatility creates opportunity when we have managed our liquidity and leverage correctly. Our primary policy, when we are looking to finance an acquisition with outside funds, is to employ leverage to offset the cost of equity, but never to the point that it creates any short-term exposure to volatility (i.e. <24 months).

Finally, we certainly do not run from risk. We welcome it openly in the right circumstance and at the right price. Our approach is perhaps best embodied in the following quote from Rick Funston of Deloitte & Touche, "You need comfort that the … risks and exposures are understood, appropriately managed, and made more transparent for everyone. … This is not risk aversion; it is risk intelligence."[1]

Fundamental Value Approach

We utilize a bottom-up, value oriented, quantitative, fundamental approach. We do not attempt to predict future movements of the markets or macroeconomic events. We look for high quality assets with strong recurring profits and reasonable prices. In many cases, we look for opportunities where combining companies with our existing assets will accelerate value creation or lower risk. One major element we focus on is the team running the target asset. We have a strong conviction that character of the leaders is a strong predictor of future returns, assuming the business has a fundamentally sound business model. The best opportunities present asymmetric upside potential: a high probability and high magnitude of return with a low probability and low magnitude of loss.

[1] Rick Funston of Deloitte & Touche said in the article "When Corporate Risk Becomes Personal," Corporate Board Member, 2005 Special Supplement, quoted from Marks, Howard. The Most Important Thing Illuminated: Uncommon Sense for the Thoughtful Investor (Columbia Business School Publishing) (p. 80). Columbia University Press. Kindle Edition.

While they may come up, especially in more distressed market cycles, we are less focused on special situations or relative valuations of assets that are not cash flowing. Our focus is to buy profits and build strong balance sheets that can survive and thrive through market cycles.

Long Term Focused

Unlike many in the private investment markets, we are not looking to acquire and flip companies in a typical 4 to 8 year horizon. Our view is that over a 20-year period (or longer), if we've done our job well and allocated to strong cash-flowing entities at reasonable prices, we are much more likely to have a higher long-term return than we if we turned over our holdings 3-4 times and incurred taxes, transaction fees and perhaps most of all, risk that we can reallocate just as wisely to the same or better assets. Our preferred model is that once we have allocated, our hold period is forever. We are looking for like-minded partners, but recognize many require liquidity events, in which case our preferred path is to buy them out or recapitalize rather than dispose of the asset.

Temperament

One of the key elements to successful investing is temperament. The greatest opportunities will come to those who work to understand intrinsic value and remove emotion in assessing opportunity and risk, whether to the upside or downside. We recognize that in the best of times, markets tend to overestimate opportunity and underestimate risk, and therefore, tend to take on more risk than the potential returns available. Conversely, in times of distress, markets tend to overestimate risk and underestimate returns. With the right temperament and a discipline to understand intrinsic value, we believe an investor can identify significant return opportunities and disproportionally low risk.

We have experienced this firsthand, both as operators and investors and are fully aware that we, like any human being, are susceptible to swings in temperament and biases that can mirror the tendencies of the market. We are not immune to these phenomena and as a result have set up structures of accountability and diversity that help us to identify our biases and make rational, unemotional decisions. Our core values, our deep faith and commitment to a patient, disciplined and contrarian mindset helps to manage temperament and delivery higher risk adjusted returns.

Market Efficiency

Financial markets tend to be efficient in the long-term, but not necessarily in the short term. Humans shape financial markets, and as a result, they can go to emotion-driven extremes. This means that most of the time markets are priced appropriately, but in the short-term price can become dislocated from value. We do not attempt to time the markets but take the opportunities that the markets give.

Market Cycles

John Templeton said, "Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria."

We make no attempt to predict the market direction but work very hard to understand where we are in the business cycle and manage our risk and expectations accordingly. We cannot improve on this process, nor express our philosophy better than to reference Howard Mark, who states, "Risk arises as investor behavior alters the market. Investors bid up assets, accelerating into the present appreciation that otherwise would have occurred in the future, and thus lowering prospective returns. And as their psychology strengthens and they become bolder and less worried, investors cease to demand adequate risk premiums. The ultimate irony lies in the fact that the reward for taking incremental risk shrinks as more people move to take it. Thus, the market is not a static arena in which investors operate. It is responsive, shaped by investors' own behavior. Their increasing confidence creates more that they should worry about, just as their rising fear and risk aversion combine to widen risk premiums at the same time as they reduce risk. [We] call this the "perversity of risk."[2]

This "richening" process eventually brings on elevated price/earnings ratios, narrow credit spreads, undisciplined investor behavior, heavy use of leverage and strong demand for investment vehicles of all types. Just as these things raise prices and reduce prospective return, they also create a high-risk environment.

Our approach is to observe these tendencies through the business cycle, assess risk and use that to identify opportunities.

Overview
In our view, our primary role is centered on (effective, efficient, and even-tempered / wise) capital allocation (whereby we intelligently bear risk for profit). Our goal is to compound value at higher rates of return while taking less risk than is commensurate with the returns earned. We see it as paramount for investors and operators not only pay attention to the return produced from a particular investment but also the risk taken to achieve that return. We utilize a bottom-up, value oriented, quantitative, fundamental approach and we do not attempt to predict future movements of the markets or macroeconomic events. We look for high quality assets with strong recurring profits and reasonable prices. We make no attempt to predict the market direction but work very hard to understand where we are in the business cycle and manage our risk and expectations accordingly. We are focused on building long-term value and our preferred model is that once we have allocated, our hold period is forever. Our core values, our deep faith and commitment to a patient, disciplined and contrarian mindset helps to manage temperament and delivery higher risk adjusted returns.

[2] Marks, Howard. The Most Important Thing Illuminated: Uncommon Sense for the Thoughtful Investor (Columbia Business School Publishing) (p. 84). Columbia University Press. Kindle Edition.