The below transcript has been edited for clarity and accuracy. **October, 2022**

Slide 0

Hello everyone, and thank you for joining the call today, and more broadly for being a part of Laughing Water Capital. I know I have been saying that I would host an investor day for some time, and for various reasons I kept pushing it out, but I think now is an opportune time to have this meeting, because as I am sure you have all noticed, the stock market is a scary place these days, and in my view the best defense against that fear is knowledge. It is important to know what you own, and why you own it. So I have some slides to go through covering an overview of the business, and my investing process, and the fundamental building blocks of successful investing, as well as some slides covering our top investments, and why I think the future is bright, and how I think our businesses will perform in the event there is a recession, and hopefully I can do that quickly, although I do want to talk about a few of our investments, and I tend to ramble when talking about stocks, and then hopefully we'll have plenty of time for questions at the end. So I'm going to put the slides on the screen, and get started.

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Slide 1

First, we have the standard disclaimer here. Please take a moment to read that, and then there will be additional disclaimers at the end.

Founding Principles

It is possible for small pools of capital to outperform the masses. However, differentiated results require a differentiated approach.

Laughing Water Capital is dedicated to maintaining every possible competitive advantage an investment partnership can have:

- Boutique size
- Small and micro-cap focused
- Go where others can't or won't = less competition
- Best ideas only
- High quality LP base
- Properly aligned investment manager

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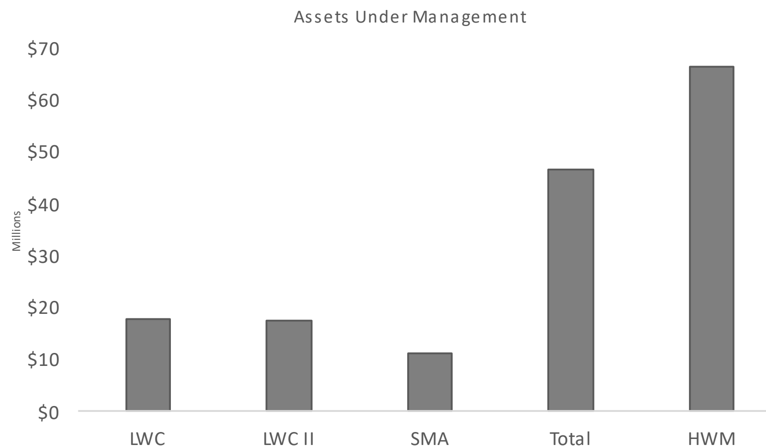
Slide 2 – Founding Principles

And then to get into it, this is just a reminder of what you all know – and you wouldn't be here if you didn't believe in it – but I strongly believe that investors can greatly enhance their returns by doing certain things that help tip the odds in their favor. And the big one there is the idea that a high quality LP base is a structural advantage in the investing world. And as you all know, this year has been a tough one for the markets in general, and our portfolio specifically, but my life has been made much easier – and I think this will translate into future returns – but my life has been made much easier by the fact that all of you on this call understand what it is that I am trying to do, and have been nothing but supportive. A few of you have asked for information about how the partnership base has been holding up, and I am happy to say that redemptions have not been an issue. In fact, a number of people have been adding capital during this difficult period, which is just great, and there has only been one partial redemption, and that is from a long-standing LP who told me about a year ago that in Q4 he was going to need some liquidity tied to a capital expense for his family investments in a private business. So no redemption requests tied to the market or my performance and only one partial redemption request that was signaled about a year in advance. And then of course, my interests are aligned with yours, as Laughing Water is the only investment exposure my family and I have outside of my wife's 401k, which is not eligible. And we are a double digit percent of total AUM, and the largest investors in the funds. So again, we are aligned.

Firm Overview

High quality Limited Partners are a structural advantage for long term investing success.



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Slide 3 – Firm Overview

Moving to the next slide – this is just a snap shot of assets under management by LW Capital Management, which is the General Partner to Laughing Water Capital, and Laughing Water Capital II, and also provides investment management services to one separately managed account, which is kind of a unique case. And the real takeaway here is just that each of the three entities – the two funds and the SMA are managed

in the same way, and I would expect that with the exception of slight differences that can be tied to the timing of cash flows, the returns will be just about the same across the entities. And from humble beginnings total AUM is a bit below fifty million at present, and that is quite a bit below our high water mark.

Operational Updates

Simple by design.

- Fully registered with the SEC
- External CFO/COO candidate identified

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Slide 4 – Operational Updates

Operational updates – there is not really not much to discuss here, but I did recently have my first interactions with the SEC, and the SEC came back with a few comments tied to the compliance manual, but nothing substantive, and it is nice to have that in the rearview mirror for now. But I do have to say that is not an endorsement. Next, this isn't really a change, but I do have an external CFO / COO candidate identified, although I have not yet pulled the trigger, except for some one-off work. And I am standing ready to pull the trigger if we get to the point where I need the extra man hours, or if I get to the point that I think having an extra hand would contribute to our investing success. But for now, the business is simple by design, and functioning well without the additional help.

Personal Updates

The halls of Laughing Water Capital are silent.

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Slide 5 – Personal Updates

Personal updates – the truth is that an investment in Laughing Water Capital the fund is very much an investment in Matt Sweeney the man, so I want to be sure to keep you all up to date on any life changes that I may have that could in theory impact the fund. I am sure we have all heard stories about fund managers going through a divorce or something like that, and then performance suffers. And I'm happy to say that there is nothing like that for me to discuss. And the only real change in my routine is that as of 5 weeks ago, my home office is quieter than it has ever been before because my youngest – my daughter Maeve who is 20 months old – started pre school. So for the first time since the founding of Laughing Water Capital I am not sometimes putting on the noise blocking headphones to block out the sounds of little feet running around my house with the nanny. And I don't think there is any reason to believe that that change to my routine could have a negative effect – and you could of course argue that I should be more productive now – but it is a change to my routine, so there it is.

Core Beliefs

Investing is simple…

…but not easy.

Stocks go up for two reasons

- An increase in per share earnings power / asset value
- A change in perception

1+1=3

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Slide 6 – Core Beliefs 1+1=3

Ok – that's really it for the non-investing related stuff, and this here is just meant to capture the absolute fundamental building blocks of successful investing, and I think it is a good idea to return to the foundation during difficult periods, and this has been a difficult year.

And the absolute foundation is that if you buy shares in a company that winds up with significantly higher earnings power a few years from today, and then the market decides to look more favorably on that business at some point in the future, you are going to do pretty well. As long as you don't over pay. And this is very simple to understand, and it should be easy to do.

But its not.

And the reason it isn't is because we live in a world where all sorts of crazy things happen, including interest rates moving dramatically higher, and inflation, and fear of recession etcetera. But there is a ton of evidence to suggest that through it all, if you find businesses that can increase their per share earnings power, you'll do just fine as long as you don't overpay going in, and as long as you don't get shaken out by the scary headlines of the day.

Core Beliefs

Investing is simple…

…but not easy.

Stocks should be valued on a normalized multiple of normalized earnings power

- Intelligent business person approach
- Don't get overly excited about the highs
- Don't get overly dismayed by the lows

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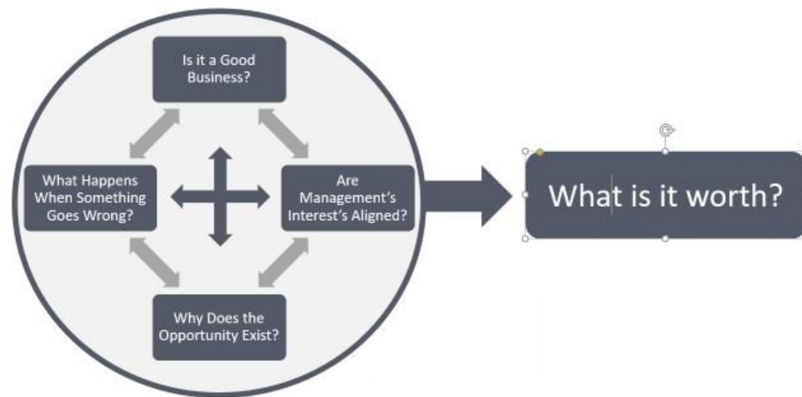
Slide 7 – Core Beliefs – Normalize

And part of not getting shaken out by the scary headlines of the day is remembering that stocks are not pieces of paper that go up and down all day. Or mostly just down lately. Stocks are ownership interests in real businesses, and again, if these real businesses can increase their earnings power over reasonable periods of time, the market will reward us. But in the interim, the market will often punish you because the market is full of people who think that bad times will have a negative impact on good companies forever, so those people value a business on a depressed multiple of depressed earnings, and history has proven again and again and again that that just isn't true. Good companies will endure, and usually come back from the bad times faster than anyone thinks, so trying to avoid the near term negatives is generally a losing strategy. The opposite of that is also true – the best times don't last forever – and we'll talk about some of my mistakes later in the presentation – but when I look at our detractors this year, in some cases I may have overstayed our welcome. But for the most part, in my view the stocks in our portfolio have been swamped by a wave of negativity that is not justified by their fundamentals, and is not justified by their valuations.

I'll talk more about our businesses in a few minutes, but going back to the last slide, I think we are very very well set up for a change in perception from here because sentiment is just awful at the moment, but I also think we are very well setup to have our businesses meaningfully improve their earnings power in the intermediate term, regardless of what happens in the near term.

Core Beliefs: Process

An effective process can tilt the odds of success in our favor



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Slide 8 – Core Beliefs: Process

And the key to taking advantage of those fundamental building blocks is sticking to a process that works over time. And here we have a snapshot of how I think about my investing process, and everything here is just designed to tilt the odds in our favor. And it really comes down to four questions before I ever think about price or value. And the key takeaway is that if you can find a good business, led by incentivized people, that is resilient through difficult periods, and that is cheap for a reason that I can understand, then the odds are tilted in our favor.

Longer Term Results

A select group of stocks, carefully chosen, can lead to outsized results.

Inception

Annualized

	YTD	1 year	3 year	5 year	Inception
LWC LP (Net)	-34.6%	-34.0%	18.6%	12.5%	17.7%
Russell Micro-cap	-25.5%	-27.4%	6.9%	3.1%	8.7%
Russell 2000	-25.1%	-23.5%	4.3%	3.5%	8.8%
S&P 500	-23.9%	-15.5%	8.2%	9.2%	12.2%

Monthly

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	LWC YTD	LWC Cum.
2016	-	9.5%	10.2%	2.1%	-1.1%	-1.9%	9.6%	2.5%	0.4%	-1.5%	2.7%	0.4%	37.1%	37.1%
2017	6.1%	-0.2%	1.6%	1.9%	-3.3%	2.9%	-0.4%	1.5%	8.4%	5.8%	3.0%	2.3%	33.2%	82.5%
2018	3.9%	-2.2%	5.9%	4.4%	0.3%	-1.7%	-0.1%	2.7%	-.6%	-13.2%	-1.8%	-8.8%	-12.3%	60.1%
2019	6.7%	2.3%	-4.2%	6.8%	-3.6%	7.0%	2.4%	-6.2%	-0.1%	2.1%	0.7%	6.4%	20.9%	93.6%
2020	-0.7%	-4.2%	-15.9%	18.7%	4.9%	4.0%	11.7%	14.9%	-1.4%	-2.8%	16.1%	13.6%	67.8%	224.9%
2021	7.0%	18.8%	-1.0%	5.5%	1.9%	1.9%	2.2%	-0.6%	-1.5%	4.3%	-7.3%	4.3%	39.1%	351.8%
2022	-9.6%	1.1%	-4.3%	-8.1%	-3.6%	-9.0%	9.9%	-4.5%	-11.7%				-34.6%	195.6%

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Laughing Water Capital, LP Class A. 2022 net of all feesSeptember 2022 and derivatives are preliminary. Not indicative of future results.

Slide 9 – Longer Term Results

And as we're coming up on the seven year mark for LWC, I think we can start to see that over longer periods of time my process is reasonably effective. Now there is no doubt that over the last seven years we have had some tailwinds, and I don't think we should count on those same tail winds to be with us for the next seven years. But at the same time, the relative results stand on their own. And of course, past returns are not indicative of future returns.

And one thing to notice here, large caps – the S&P 500 – have really outperformed small caps. I mean, about six percent a year over the last five years is massive outperformance. And I'll talk more about this on the next slide, but historically small caps have outperformed, and that hasn't been the case in recent years, but there is reason to believe that a regime change might be on the horizon. And that regime change should benefit us because of course small caps are where I spend most of my time.

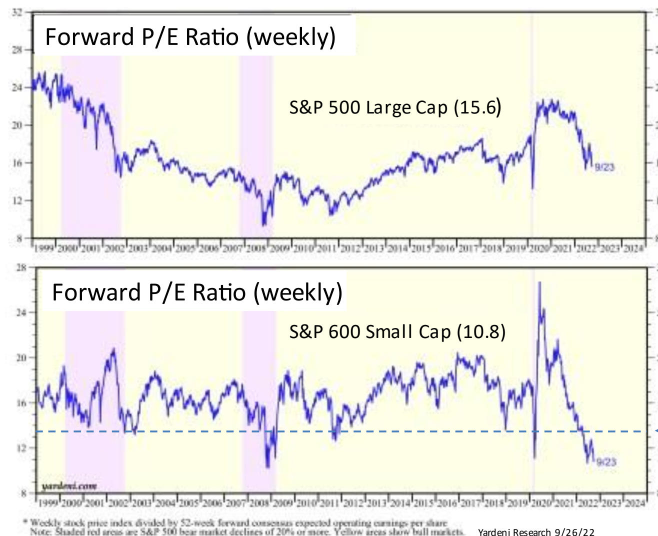
And I'd also like to add that these results were based on a portfolio of stocks that for the most part were boring, simple businesses, with some of them being more traditional "value" investments, and some of them being on the growthier end of the spectrum, but at no time were we taking large factor bets on growth, or sector bets on SAAS, or anything like that. With maybe one or two exceptions the thesis has always revolved around intermediate term estimates of cash flows or asset value, and just focusing on businesses that are a bit off the beaten track, without any real sell side research coverage, and that is where the opportunity lies.

And this is the seven year view, and it looks good. But on a quarterly basis, we were pretty close to fifty-fifty on beating the indexes, and specifically in 2018 when small caps got hit we lagged behind, and again in the early days of Covid when stocks got hit we got hit a bit harder, and over shorter periods of time we often trailed the market, and we are trailing the market again today, although I saw something the other

day that the average stock in the Russell 3,000 is down something like forty percent and we're doing better than that.

Shorter Term Results

Small Caps are historically cheap, and historically out of favor vs. large caps.



Assume 20% cut to earnings

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Slide 10 – Shorter Term Results P/E

So I am proud of that last slide, but the rearview mirror is not much use to us at this point.

But let's try to put the current drawdown in context a bit. So this slide just shows multiples on large caps and small caps since 1999. And the thing that jumps out is that right now large caps – the SP500 – which is what most people call "the market" is not really all that cheap right now at 15.6x. Maybe not expensive, but not cheap either. Small caps on the other hand – where we play –at 10.8x are at levels only seen in the depths of the Financial Crisis and the depths of Covid. Significantly cheaper than after the tech bubble. And I didn't want to squeeze it onto this slide, but if you look at the ratio of large caps to small caps, small caps are two standard deviations below large caps, and basically a record spread.

Now the obvious problem here is that these are forward multiples, and there is of course denominator risk, meaning that the E can come down. But even if the E does come down for small caps, the current P/E is so low that the E could come down quite a bit and they would still look cheap versus history. So for example, I added that blue dotted line which would show the forward P/E if earnings estimates were cut by 20%, and if you cut by 20%, small caps are still cheap versus the last 20+ years and the tech bubble, but just not as cheap as the Financial Crisis and Covid.

The other obvious problem is that this chart only goes back to 1999, and you can go back to the late 1970's and see that the market multiple was something like seven or eight X. So there is precedent. But At the time rates were in the teens, which is of course much higher than where we are today.

Shorter Term Results

We are often intentionally investing in businesses with near term uncertainty.

"The 13 years I ran Magellan, the market went down nine times 10% or more. I had a perfect record —I went down more than the market, every time."

~Peter Lynch

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Slide 11 – Shorter Term Results Peter Lynch

On to the next slide. So that was some context of our portfolio versus the market. This is context of our portfolio versus expectations.

And here we have Peter Lynch, who compounded at thirty percent a year while running the Magellan Fund, but always trailed the market during difficult periods because he was intentionally buying things that were out of favor. And I am also usually buying things that are out of favor, or at least where the market doesn't know what to do because the business is going through some sort of fundamental change that explains why earnings will be higher looking out a few years. And during difficult periods the market craves certainty, but I am intentionally buying uncertainty – which is of course different than risk – with a view that over reasonable periods of time the business will increase its earnings power, and perception will improve, and one plus one might equal three. But it takes time for that approach to work. Businesses don't complete transformational change in one month or one quarter. I think three to five years is the right framework.

Drivers of Our Future Success

A select group of stocks, carefully chosen, can lead to outsized results.

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Slide 12 – Drivers of Our Future Success – Top Stocks

And here is the forward view. So again, the rearview mirror is of little use to us at this point, and we need to be looking forward, and here I have nine of our top ten stocks – there is one that I excluded because I am currently working on it and may be trading it - and the top ten represents about seventy five percent of our capital, and will be responsible for the lion's share of our future success. And I'll go through some of the important characteristics of these businesses in a few minutes

Drivers of Our Future Success

A select group of stocks, carefully chosen, can lead to outsized results.

Portfolio Evolution

- Increased focus on quality
- Still small and off the beaten path, but increased focus on liquidity / slightly larger market cap
- Slightly less top heavy
- Starting to lean into some more cyclical names
- Smaller positions with a wider range of outcomes, but potential for massive upside

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Slide 13 – Drivers of Our Future Success – Portfolio Evolution

But first, I want to make some high level comments about how I am thinking about the portfolio these days given all the uncertainty in the world. And the first thing is just an increased focus on quality. Over the last seven years there were more than a handful of investments where the returns were more about the change in perception than the change in earnings power. There were definitely some compromises on quality as I leaned into some of the kind of cute special situation type dynamics, and with a favorable macro backdrop you kind of have a natural tail wind to perceptions so the timing is less important, so it is easier to get away with compromising on quality a bit. But it seems clear that the macro backdrop at present is not as favorable as it was over the last few years, so I think the way to correct for that is to focus on higher quality businesses, and stretch the time line a bit, so that the result of the investment will be tied more to how earnings change with time. I still love the special situations and we still have some in the portfolio, but I am just less willing to compromise on quality.

Next, the average market cap of the portfolio has come up a bit. Still very much in small cap territory with an average market cap of somewhere around one billion, and there are still some smaller legacy names in the book, but in general, options have value, and liquidity is an option in the event that I make a mistake, or a better opportunity comes along, or whatever it may be.

The next is that the portfolio is a bit less top heavy than it has often been in the past. And I think most investors say that during difficult periods it makes sense to concentrate even more in your best ideas, but I don't really agree with that. In my view, if you're finding more ideas with similar potential outcomes, it makes sense to diversify a bit more so as to remove some of the single stock risk. So we are still top heavy, and the names on the earlier slide will still be the driving force of our portfolio, but we are a bit fatter around the middle at the moment.

And part of that is tied to the next bullet point, which is that I am starting to lean into some more cyclical names a bit, and that actually ties to the last bullet point as well. And the reality is that cyclical names can struggle more in a downturn, but that is not what matters. What matters is what is in the stock price, and it is cliché to talk about the coiled springs in the stock market, but the cyclical names tend to get more coiled and have more upside assuming an eventual return to normal than less cyclical names. So what really matters is how these types of names will do coming out of the turn, and history has shown that they can really bounce and go much higher much faster than anyone thinks. And I'm going to talk about some of these names in a few minutes. But the reality is that owning these sorts of things is the opposite of what most market participants are doing at the moment. These are not flight to safety names. These are focus on maximizing results over three to five year period names. And that is what I always do.

Core Beliefs

Investing is simple…

…but not easy.

Stocks go up for two reasons

- An increase in per share earnings power / asset value
- A change in perception

1+1=3

Slide 14 – Core Beliefs

Moving on – we saw this slide earlier – but again the two things to really focus on are increasing earnings power, and changing perceptions, and we're going to talk more about that on the next two slides.

Earnings Power Improvement

If earnings power is meaningfully higher a few years from now, we will be well rewarded (unless we over pay)

	Organic Growth	Inorganic Growth	Operating Leverage	Cost Out	Buy back/ Debt down	Divest / Spin off
APG	X	X	X	X	X	X
Cannabis	X	X	X			
CDMO	X		X		X	
GFF			X	X	X	X
HGV	X	X	X	X	X	
LNDC	X		X	X	X	X
PAR	X	X	X			X
THRY	X	X	X		X	X
VTY-LN	X	X	X	X	X	X

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Slide 15 – Earnings Power Improvement

So, this is a high-level view of how I think about Earnings Power Improvement at our top names, and the key take away is that all of them have a well-defined strategy to improve per share earnings power, and for all of them there are multiple ways to win. Now, the first two columns are tied to growth, but in most cases we are talking about rather boring growth, and a long history of growth. In most cases the way to think of that growth is kind of mid single digit to maybe low double digit organic growth, with maybe some inorganic growth on top, but that kind of growth combined with some margin improvement and capital return can really drive per share earnings power. There is also an opportunity to take cost out of several of our names, and then there are also other more special situation type levers for our management partners to pull, all of which should drive earnings power. I am going to talk about some of these names in more depth in a few minutes, but for now I am just going to say that I think for all of these businesses there is a clear path toward dramatic change in per share earnings power over the next few years and then move to the next slide

Changing Perception

If the cloud of negativity has risen a few years from now, we will be well rewarded (unless we over pay)

	Business Transition	Simplified Story	Time	Normalize Earnings	Strength Through Cycle	Other
APG	X	X	X	X	X	X
Cannabis	X	X	X	X	X	X
CDMO	X	X	X	X	X	
GFF	X	X	X	X		X
HGV	X	X	X	X	X	
LNDC	X	X	X	X	X	X
PAR	X	X	X	X	X	
THRY	X	X	X	X	X	X
VTY-LN	X	X	X	X	X	

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Slide 16 – Changing Perception

And this is a high-level view of how perception is likely to change over time. And the number one thing to think about is that all of these businesses are going through some sort of transition. They are all dealing with some sort of problem or puzzle that the market has a hard time deciphering. In my view if you do the work you can see that the future is not going to look like the past, but the market is not very good at figuring out that sort of transition before it shows up in the numbers. So very quickly to just pick a few, Avid Bioservices is building a new factory that will more than double sales, and it is likely they will fill that factory very quickly. Griffon Corp is in the midst of an activist battle that has them looking to sell off some pieces of the conglomerate and massively cut corporate level costs. Landec right now screens as a food company because they have an avocado business, but they are in the midst of selling that to focus on a high quality CDMO business. APG recently made a large acquisition, where they bought fire safety assets

from Carrier Group, and Carrier Group had basically neglected those assets because their core business is HVAC, so there is a lot of room for APG to improve that business.

But the real point is that all of these stories make a lot of sense, but all of them are complex and messy, and the market just isn't good at figuring those things out, in large part because they take time. These are multi-year transitions, and the market only cares about what is going to happen next quarter. And there is no doubt that all of these transitions will have bumps in the road, and some of them probably won't work out as well as I hope, but as a group – as a group i think these businesses have a clear path toward improving their earnings power, and benefitting from a change in perception as the stories become cleaner with time, and that combination is very powerful. One plus one often equals three.

What Happens in a Recession?

The elephant in the room

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Slide 17 – What Happens in a Recession – The Elephant in the Room

OK – now the big one. The elephant in the room. What happens in a recession? And I think there are a few different ways to answer that question, and the two main ways I think to answer that question is what happens to the businesses you own, and what happens to the stocks of the businesses you own. And the first question – the part tied to the actual business – we have a reasonable chance of answering using history as a guide, and business fundamentals as a guide, and if you recall from the earlier slide on process, one of the main questions I ask during a research project is, "what happens when something goes wrong," because if you own businesses and stocks long enough, you're going to encounter a recession, and from the outset, I have always wanted to own businesses that were recession resilient –and that has been a drag at times over the last few years – but I think it is the right approach through a cycle.

What Happens in a Recession?

A key part of our process is understanding what happens when something goes wrong.

	Divorced From Real Economy	Less Cyclical Than You Think	Stronger in Weak Economy	Been Here Before	Other / Special Sit
APG	X	X	X	X	X
Cannabis	X				X
CDMO	X		X	X	X
GFF				X	X
HGV		X	X	X	
LNDC	X				X
PAR	X		X		X
THRY		X	X	X	X
VTY-LN		X	X	X	X

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Slide 18 – What Happens In A Recession Table

So again here we have the top holdings, and how I think about them in terms of a potential recession. And I don't want to seem blasé about this. I hate the idea of a recession and drawdowns in our portfolio as much as anyone, but again, all we can do is be prepared, and I think we are well prepared.

And the first column is those investments that are divorced or at least mostly divorced from the real economy. And Avid Bioservices and Landec – soon to be renamed Lifecore, are two that I wrote about in the last letter, and they are contract drug manufacturing organizations. And the stocks trade in all sorts of crazy ways – up ten percent one day, down ten percent one day, on no real news. And the only news of note in recent weeks is that Regeneron – a major player in the space - had an investor day and detailed how they expected volumes of biosimilars to triple over the next few years as some of the more seasoned biologics roll off patent and invite biosimilars to compete, and there just isn't enough manufacturing capacity to handle all that demand, let alone the fact that most new drug development these days is in biologics, and Avid Bioservices and Lifecore – which is Landec's CDMO arm – are primed to benefit from that. And it doesn't matter if there is a recession tomorrow. These drugs are still going to roll off patent, and pharma companies are still going to make generic biosimilars whether the economy is booming or soft, so I think we will be just fine – these businesses should greatly improve their earnings power.

And then there is PAR, which is just a toll road on fast food restaurants. And fast food or quick serve does very well during recessions because people trade down, and if the restaurant is open PAR gets paid.

And then there is APG, whose core business is fire control systems for buildings, and by law building owners have to maintain their fire control systems regardless of what else is happening in the world. And I actually have a friend that is NYPD at JFK airport. His son and my son are in class together. And for a while he was pulling overtime at JFK because there was a hangar whose fire control system was offline, and under the terms of the insurance on the hangar, if the fire control system was offline, they had to have

two uniformed officers stationed in the hangar 24/7 to make sure there were no fires. And think of the cost of paying two cops overtime to sit there and drink coffee, versus just maintaining the system when the average cost for inspection is a couple thousand bucks.

And then there is cannabis, which I will talk more about in a few minutes.

And to be clear, each of these businesses has its own problems and uncertainties, but those problems and uncertainties are not really tied to a recession. And to be clear, I am talking about the quality of the business here – not the stock price – the prices can definitely go down in a recession, even if the businesses are mostly immune, but the key questions to ask are, "can you imagine a future where fire control is no longer mandated?" Or "can you imagine a future where quick serve restaurants no longer need software to run their operations?" The stock prices might suffer in the near term, but these businesses will continue to grow and improve, and at some point the market will recognize that, and value them on a normal multiple of normal earnings. And I think we will get paid.

The next column is businesses that do have a cyclical element to them, but are less cyclical than you would think, and that comes down to perception and price and quality. And HGV is a name that is new to the portfolio. HGV is Hilton Grand Vacations, which is the Hilton branded time share business that was spun off from Hilton Hotels in early 2017.

And, for obvious reasons HGV gets lumped with hotels which are clearly cyclical, but this business is actually very different. For this business, about fifty percent of EBITDA is tied to resort management and financing and that revenue is recurring, and another twenty percent is tied to twenty five years of cohort data that shows that customer behavior around upgrades is highly predictable and very stable, so about seventy percent of the business is stable.

Now, the other call it thirty percent of EBITDA is tied to new sales and rentals, and that is a bit more variable on the top line, but the cost structure is also highly variable because commissions are about sixty percent of the expenses tied to new sales. But if you dig in a bit more, you'll see that during the Financial Crisis, industry sales were down thirty five percent, but Hilton sales were only down three percent. And you really do have to dig in – I know I cite this all the time, but according to JP Morgan, eighty percent of investment decisions these days are made by computers that are using quantitative inputs, and those computers are blind to that very limited three percent decline because at the time, HGV was part of the larger Hilton Hotels umbrella, and the larger Hilton business was not public, so that eighty percent of the market has no idea how resilient this business has been in the past, and instead is forced to just bucket this business with other hotel and travel businesses which are way more economically sensitive. And by the way, Hilton Hotels has twenty two sell side analysts that cover it. HGV has three. And that's just a great place to start to understand why a stock might be cheap. The trailing financials don't tell the whole story, and the forward financials are limited because there is not much sell side. You have to do the work.

And in the interest of time I don't want to go to deep into it – maybe we can talk more during the Q&A - but I think there are cultural and structural reasons why HGV did so well through the financial crisis, and I think they'll do pretty well through the next down turn as well.

So look, is this business recession proof? I would not argue that. But I would argue that it is way way more recession resilient than the market gives it credit for broadly, and if you look at current valuation more specifically, the stock is trading at about seven or eight times this years implied free cash flow guidance,

and about six or seven times next year's, and I think there is a strong argument that they could double per share earnings power over the next few years as they integrate last year's acquisition of Diamond Resorts and complete some other internal initiatives, and if you're trading at six or seven times free cash flow, and there is a reasonable path to double that free cash flow, it sets you up for three, four or five bagger type returns over the next few years.

But just because it is trading at six or seven X free cash flow today doesn't mean it can't trade at five X tomorrow. And it doesn't mean that free cash flow won't take some sort of dip before it goes on to double in the future.

But here's the big question. Does anyone believe that whatever recession might be on the horizon will be so bad that people will never want to go on vacation again? Does anyone believe that the idea that people will want to stay in luxury properties in beautiful locations will somehow get disrupted? I mean, maybe Zuckerberg and the metaverse is a threat? Or if Elon takes us all to Mars? This business is a cockroach. A luxury cockroach with beautiful beaches, but still a cockroach.

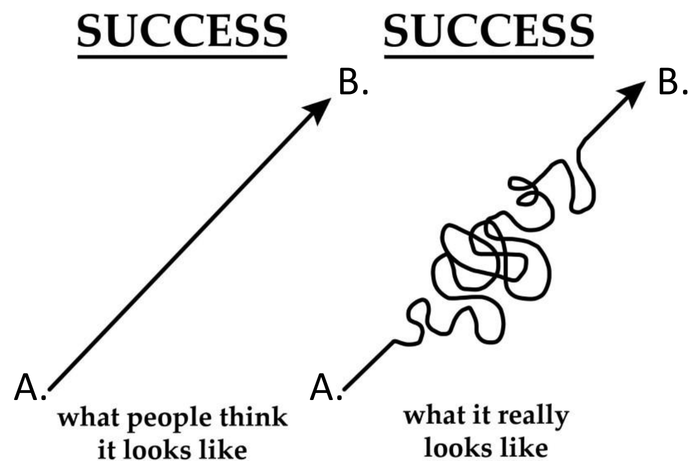
So if you zoom out, I think the best thing to do is ignore interest rates, ignore recessionary warnings, ignore all the noise, and instead focus on an impossible to replicate brand – Hilton is the number one global hotel brand by the way, nearly impossible to replicate portfolio of properties, a long history of behavior by customers and management that suggests that this business should actually improve in the longer run if there is a recession in the near term, and of course focus on the normalized per share earnings power, and how it can improve with time.

So that's HGV. And there are similar stories to tell with our other companies. Thryv for example – they sell software to small and medium businesses, and you normally think that SMBs get crushed in a recession, but something like eighty percent of their customers are relatively immune – like plumbers for example – plumbers keep on plumbing straight through recession. And if you track visits to their website, visits are up double digits, and the CEO who is fantastic and already owns fifty or sixty million dollars of stock personally has been buying more. And Vistry – which is purchasing Countryside – we will talk about more in a minute but I think that is a great transaction, and the Partnerships business is a much better business than traditional home building.

So, the real takeaway is that yes there is recession risk on the horizon, but the businesses we own are primed to perform just fine through any recession, and in fact I would argue that a recession is already priced into these stocks, and the answer is just to be patient, and realize the market is forward looking, and there is a ton of evidence to suggest that the market will figure out the brighter future before that brighter future shows up in the data. The important thing for us and our portfolio is not what happens any given quarter. It is understanding that for the most part, our businesses are all going through some sort of drastic change, and if they are reasonably successful in navigating that change, their earnings will be a lot higher a few years from now than they are today. Earnings could stink next quarter. But the businesses will be a lot different a few years from now than they are today, and a recession is not going to stop that change. In some cases it may delay a bit. But its not going to stop, and in some cases a recession will actually probably accelerate the change. And how we will get paid is by waiting for the market to figure out that these businesses are totally different a few years from now. The fundamental building blocks – increased earnings power, and a change in perception. I think we score very high there.

What Happens in a Recession?

The destination is more important than the path.



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Slide 19 – What Happens In a Recession – Success

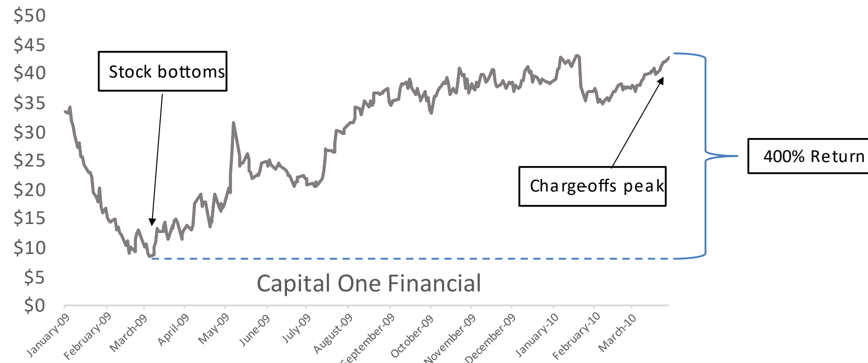
So we just talked about what is likely to happen to our businesses in a recession. As for what happens to stock prices during a recession, that is a harder question to answer. In fact, I would say that is an impossible question to answer with any certainty because there are no limits to the madness of crowds. And again, there are a lot of lessons from history – and the data is very clear – and there are a lot of quotes from all of the famous investors on this topic, but the key takeaway is that if you own good businesses, run by good people, and you can understand the opportunities in front of them, you will be fine with time. But in the short term, the market will often put a lower than normal multiple on lower than normal earnings, and the mark to market is painful. And that's where we are today.

And I know that is not very comforting, but there is an enormous amount of evidence to suggest that for investors, the best path from point A to point B is to not worry so much about the path. Rather than worrying about the quarter to quarter path, spend your time on the process, and how low the bar to success is, and how much common sense is involved in reaching the goal. And be cognizant that there are going to be bumps in the road, but resilient businesses and good management teams have a way of adapting to those bumps, and taking advantage of those bumps over longer periods of time. And recessions are clearly bumps, but if you own businesses that are capable of handling recessions, then the equation becomes more about emotions and patience more than anything else, and that is an area where it is possible to have a behavioral edge, and I believe we have it. And at some point you just have to ask if you can imagine a future where people won't want to go on vacation to luxury resorts. Or I mean can you imagine a future where insurance commissioners won't require fire inspections in large buildings. It will be really hard for that to change, and that is true for just about all of our businesses.

What Happens in a Recession?

The market is forward looking – by the time it looks safe, it is too late

Don’t miss the turn.



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Slide 20 – What Happens in a Recession – Capital One

And this slide just demonstrates why patience is the answer. I could have trotted out any one of a million different quotes by Buffett and other legendary investors about patience and ignoring the macro and focusing on your businesses, but this is the example I always think of, so I wanted to share. And this is a chart of Capital One Financial during the Financial Crisis, and the real point is that the market is forward looking, and if you spend your time worrying about the short term negatives, you are very likely to miss the turn, and the turn comes way before anyone expects it, and the turn is violent. And in the case of Capital One, the stock was beaten up due to rising delinquencies and charge offs on their credit cards through the financial crisis. And the stock bottomed in March of 2009, like most stocks, but if you were just looking at the negatives – just looking at the data - charge-offs did not peak until March of 2010 – a full year after the stock bottomed – and by the time the data gave the all clear signal, the stock was up four hundred percent. Now, this is a cherry-picked example, and a credit card company during the GFC had more than a few things to worry about, but the point again is that for the most part, investors are best served by focusing on how earnings power can improve over time, and how perceptions can change over time, and if you can get those two things reasonably right, you are very likely to be pleased by your outcome, even if there are bumps in the road along the way.

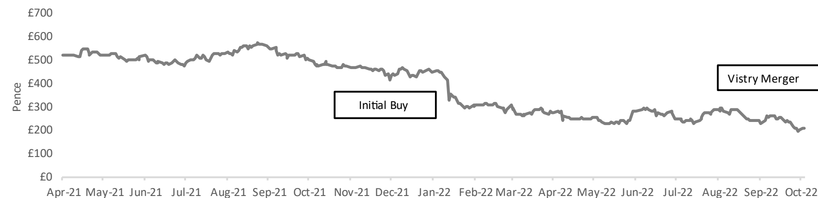
Mistakes & Bad Outcomes

Top Detractors YTD

Countryside Partnerships (CSP-L) -> Vistry Group (VTY.L)

- Failed to anticipate own goals
- Failed to anticipate difficulty recruiting new management
- Macro has deteriorated
- Transaction with Vistry makes a lot of sense and solves a lot of problems
- Valuation more than accounts for the macro challenges
- Management voting with their wallets as they buy shares in the open market

Conclusion: Thesis has evolved, but the future remains bright. More patience needed.



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Slide 21 – Mistakes & Bad Outcomes Countryside

So, that is it for an overview of where we are now, and where we will be going forward, but I want to spend a few minutes talking about how we got here, and a lot of that is just the market, but there are also more than a few mistakes and bad outcomes that are worth chewing on a bit, so I am going to quickly touch on our biggest losers this year, and I think there is reason for hope.

And the first one is Countryside Partnerships our UK homebuilder, which I first bought about a year ago at GBP 4.50 or so, and about a month ago it was announced that Countryside would be acquired by Vistry Group, another UK homebuilder, at a headline price of GBP 2.49, so on the headline, clearly a very disappointing outcome, although the headline is misleading because it is a mostly stock deal, and I think the stock is very undervalued.

The original thesis was that Countryside essentially had two businesses, one a traditional asset heavy homebuilder, and the other is an asset light builder and activist investors had gotten involved, and they were going to run off the asset heavy business, and then use the proceeds to repurchase shares, and then focus on the asset light side, which has very high returns on capital, and produces a lot of cash, and is less cyclical than the asset heavy side, and broadly speaking is just a better business, and that should contribute to a change in perception, as well as a change in earnings power. And part of the logic was if the stock goes down in the near term, that's ok, because they were going to repurchase forty percent of the float or something like that, and homebuilding is a business that is not really subject to disruption.

What I got wrong is that as part of their plan to stave off the activists, management and the board decided they would grow, and they would grow at any cost. And if you think of the CEO's job in this business, it is really a capital allocation job. If there are two projects that you can bid on, and one of them has forty percent returns on capital, and the other has fifteen percent returns on capital, quite clearly you should do the forty percent one. But if you're trying to grow for growth's sake, then maybe you start doing some

of those lower return projects. And if you're expanding into a new region, it makes sense to set up a satellite office and a skeleton workforce until you generate some business, and then build out the office more to meet the opportunity. But if you're really trying to prove you can grow, maybe you build out and staff a full office before you even have any business, and that then weighs on margins. So there were really some own goals here because management did all the wrong things in pursuit of growth, and they showed up in the stock price.

The next thing I got wrong is that I didn't anticipate any real problems in recruiting a new management team. One of the activists, Browning West, bases their whole business model on recruiting and installing world class management teams, and they have had a lot of success, so I thought we were in good hands. But it turns out that five or six years ago one of the UK homebuilders gave their CEO a one hundred million pound bonus, and there was massive backlash on that, because this is a B to G – a business to government business – where ultimately the customers are the tax payers, and why should these homebuilders have the margins to support a hundred million pound bonus? Why should that come out of the taxpayer's pocket? So anyway, it was a big scandal, and I failed to uncover it during my research, and this big scandal made it difficult for Countryside to recruit a high quality management team, because high quality management teams want to get paid a lot and no one wants the scrutiny.

So we wound up in a situation where margins and performance were suffering b/c of these misguided growth attempts by a temporary management team that was difficult to replace, and that led to one of the activists – Inclusive Capital – issuing a statement that they would take it private, and that then turned into a call that they should just sell the business, and the problem with that is that because the company initiated a sales process, they had to turn off the buybacks, so the idea that short term share price weakness would lead to long term success was taken out back and shot.

Anyway, fast forward to today, and Vistry is buying Countryside in a mostly stock deal, and I think this transaction makes a ton of sense, and we will ultimately be richly rewarded. First, Vistry management is very highly regarded, so the management problem is solved. Second, the combined entity will be the largest builder in the UK, and there are benefits from scale etcetera. Third, I don't know how to quantify this, but I think another thing I underappreciated going in was that on some level, there was likely some resentment from British investors, and Countryside's management team and board of directors, and even the British sell side that a bunch of Yanks were coming in and telling a UK company what to do. But now the headline looks like a UK company rescued a company that the US activists screwed up, which is just better optically for a London listed name. Beyond that though, the top down view is very compelling, and the valuation is very compelling, and Vistry has already said that if the market doesn't realize the value of the combined business in two or three years, they will take steps to force the market to realize that value through a spin off or similar.

Going to valuation. Vistry guided to GBP eight hundred million of pro forma EBIT, with GBP four hundred million of that being from the traditional business, and four hundred million of that being from the Partnerships business, and the current EV is something like two and a half billion, or three point four times consolidated EBITDA give or take, or about six point three times the EBITDA from just the traditional business. And right away, six point three times for a homebuilder does not strike me as a crazy multiple assuming that at some point in the not too distant future the world is "normal" again, which suggests the Partnerships business is basically being given away for free. Or another way to look at it is that if you think the traditional homebuilder could easily be worth one point three or one point four times book value –

again, not at all crazy assuming some kind of normalcy returns at some point – then you are covering the whole EV with just the traditional business, and management actually alluded to this on the merger call.

Now, I get it. The original thesis with Countryside was that we were going to get away from traditional homebuilding to just focus on the asset light Partnerships business, and now here we are back in the traditional homebuilding business, so more than a little evidence to suggest I am suffering from thesis drift. Especially when you consider the macro etcetera. But this is why I think we are still in great shape on a reasonable time line.

We just went through how on a normalized basis we are not really paying all that much for Partnerships, and management has guided to GBP four hundred million of EBIT from Partnerships, and because of its higher returns on capital and lower cyclicality, that EBIT should get a higher multiple than the traditional EBIT. But digging deeper, it seems clear that management is totally sandbagging that four hundred million number. They break it down as one hundred fifty from Vistry's Partnership business, two hundred fifty from the Countryside piece, and then inclusive of fifty million in synergies. But here is the problem. Prior to this transaction, while they didn't explicitly guide for the Partnerships business, if you connect the dots on what Vistry management was saying, they were essentially guiding for two hundred million of EBIT. So that is an extra fifty million. And then on the Countryside side, they were whispering about three hundred million of EBIT for their Partnerships business after working through some of the very fixable mistakes of the prior management, so that is another extra fifty million, before getting to synergies. And the whispers out of Countryside were they thought a strategic acquiror could realize sixty to eighty million of synergies on top of the EBIT. So add it up and you have Vistry management guiding to four hundred million of EBIT while making it crystal clear they like to under promise, and the numbers are conservative, and then when you dig in a bit you can come up with another one hundred fifty or one hundred eighty million of EBIT. And to be clear, it will take a few years to get there, and there are of course macro concerns, but it is not hard to draw a line to the Partnerships business doing maybe six hundred million of EBIT looking out a few years, and the business runs net cash, so we can theoretically ignore the interest, tax it by twenty five percent, and come up with four hundred fifty million of after tax profits looking out a few years. So that's like GBP 1.30 a share, vs. the current stock price of GBP 6. So four or five times potential future earnings of just the partnerships side, with no credit for the traditional side.

Now what is that worth? The Partnerships business is different than traditional homebuilding – it is much less cyclical. This is essentially government sponsored low income housing, and right now in the UK there are something like one point two million people on the waiting lists for low income housing, and something like twenty or twenty two thousand vacancies. And every year forty or fifty thousand new units are built, and another one hundred thousand people join the waiting list – so the top down view is very favorable. The government needs to help build these houses. And again, this is a business that can generate more than forty percent returns on capital, and generate a ton of cash which can then be returned to shareholders or reinvested in the business, so I don't think it is crazy to think that this business might ultimately get a twenty X multiple on after tax earnings. That might be aggressive. But that's ok, because right now if you squint we are kind of getting it for free, assuming that at some point the world is normal. If twenty X is the right multiple, we're talking about GBP nine billion of equity value from the Partnerships business alone looking out a few years, versus a current market cap of a bit more than two billion. And we're not even talking about share repurchases – which if you look at the holders list I can promise you they will be asking for buybacks, and again, insiders have bought stock in the open market

over the last few weeks so we know they think this is a good deal and the stock is cheap – and we're not even talking about cash that will get stacked on the balance sheet in the interim, so the bottom line is I think this could be up four or five X from here in maybe five years.

But it could also be down next month or next quarter. And quite clearly, I am glossing over the near-term macro risk, and then there are currency issues, which have also hurt us… although the data on currency mean reversion is pretty convincing. Anyway - I just covered the things I got wrong so far, and they're bigger than a bread box. And I am not ignorant of the effect interest rates have on housing, and I am aware of what commodity inflation has looked like, and then of course there is FX to think about too, but I think you have to be open to the argument that all of those things are in the price and then some when I think there is a path to a four or five X in five years, so I think our best path forward is to ignore all of that, and instead focus on the idea that the UK is chronically undersupplied when it comes to low income housing, Vistry is the largest player, the government is determined to fight that problem, and homebuilding is not going to be disrupted any time soon. I think if we're patient, we're going to do very well here. I'd also note that I sold almost all of our Countryside, collected the tax loss, and then bought Vistry.

Mistakes & Bad Outcomes

Top Detractors YTD

Transact Technologies (TACT)

- Unanticipated continued supply chain disruption
- Lumpy ordering on software side leads to dramatic swings
- Working capital swings tied to inventory stocking
- Competitive positioning in core business improved
- Additional activists ramping up pressure

Conclusion: Probably over stayed our welcome. Success still possible

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Slide 22 – Mistakes & Bad Outcomes – Transact

Moving on to Transact, which we still own as a smaller position. The original thesis was that they are one half of a duopoly in slot machine printers, which is a good business because if you are a slot machine OEM, you have a ten thousand dollar piece of equipment that is completely useless unless you have a high quality printer, so you care more about quality than price, and then there is regulatory review involved as well, so this is not just a commodity hardware business. And they had a few other niche printer businesses, which are much more commodity in nature, although these little printers are more complex than you would think. Anyway, as an outgrowth of printers they had in restaurants they started developing a recurring revenue software business, and it was growing very fast, and they started shutting down the

other commodity printer businesses to really just focus on slot machines and restaurant back of house and software. And the financials were completely polluted by all of these other little businesses that were getting shut down, but you could kind of look at it and say that the value of the high margin slot machine business covered the entire enterprise value, so you were getting this free option on a fast growing SAAS business. And that thesis was working very well for awhile, and then it went off the rails. And part of the problem here is that China basically stayed in Covid lockdown much longer than I expected, and the company had trouble getting component parts for their hardware, which of course hit sales. But they now seem to be back on track, while industry scuttlebutt is that their main competitor is still telling people it could be nine to twelve months before they can ship product, so that should be an opportunity to take price, or take market share. And the other part of the problem is that the software business is still small, and lumpy ordering from large customers can really swing the numbers around from quarter to quarter. So we'll see. This is back of house software, and commentary from all the restaurant software players has been that the last two years has mostly been about front of house, but now there is increased emphasis on back of house. Either way - at present the value of the slot machine printer business on a normalized basis exceeds the enterprise value by quite a bit in my estimation. The SAAS business is harder – there are still signs that it could take off, but management has a habit of over promising. There are several large shareholders holding management's feet to the fire though, and I think it will be hard to lose money here, and we could still wind up doing quite well. There has also been some insider buying, which is of course nice to see.

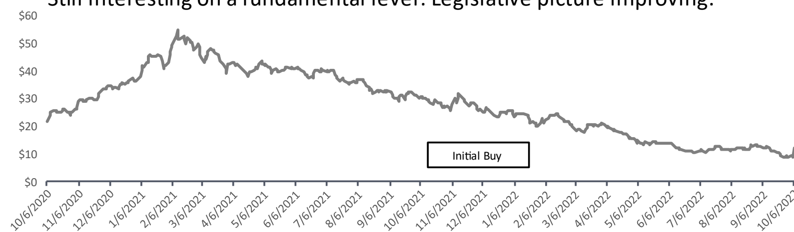
Mistakes & Bad Outcomes

Top Detractors YTD

Cannabis Basket (MSOS)

- Failure to invert my assumptions around liquidity
- Numerous state level political delays
- Continued uncertainty regarding Federal legalization
    - 10/6 Biden considering executive action. MSOS up 34%

Conclusion: Failed as a portfolio hedge during a difficult macro period. Still interesting on a fundamental level. Legislative picture improving.



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Slide 23 – Mistakes & Bad Outcomes – Cannabis Basket

I was preparing notes on this last week, and I got an email from one of the leading voices in Cannabis investing – and I mostly ignore these types of things – but the email pointed out that on September 26th, all of the cannabis stocks combined traded a total notional value of thirty seven million dollars, and that is on total market cap of thirteen billion dollars. That is zero point three percent of the whole industry

trading that day. Which basically tells you that there is no volume at all in cannabis land these days. Now the original thesis was that this was in many ways a hedge. The idea was that if interest rates go up etcetera, cannabis is still going to march forward state by state, and at some point we will see Federal legalization, and then there will be a flood of capital. And I still think that view is correct. But what I really screwed up is that part of the upside case is that at present very few people can invest in cannabis. Most of the banks won't custody cannabis stocks. So the upside case is that when legalization comes, there will be this flood. But I failed to invert that logic, and if you flip that logic upside down, there are no incremental buyers. Anyone that can own cannabis already does, so when there are bumps in the road – some state adoptions have been pushed out etcetera, or when people want to take tax losses, there is no incremental buyer. And if there is no incremental buyer, and liquidity is non-existent, the stocks really get hit hard, so this has really hurt us, and its mostly just a very stupid mistake on my part. But then yesterday there was news out of the White House that Biden is considering executive action, and the MSOS was up thirty four percent. And right now Cannabis is regulated the same way that heroin and fentanyl are. But if it is reclassified as Schedule three or four, then 280E goes away. 280E says that you have to pay taxes on your gross profit. You don't get to deduct operating expenses before paying taxes.

So we'll see. There are still a lot of interesting things happening, and with some movement on the legislative side, that is a good thing.

Three Minutes on Macro

The next few years are likely to be more challenging than the last few years.

- Inflation
- Interest rates
- Recession
- Expectations

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Slide 24 – Three Minutes on Macro

Ok – so that's a summary on some mistakes and bad outcomes. And I think the final chapter has yet to be written on all of those, but there were definitely things that could have gone better, and definitely things that I could have done better, and unfortunately that will always be the case. And on a portfolio level, I think the takeaway should be that most of our year to date decline has been tied to multiple compression on names that are primed to expand their earnings power and benefit from a change of perception looking out a few years, but we have also had some bad outcomes, and I have also made mistakes. The multiple

compression piece is largely tied to the macro – and multiples this year have compressed by forty percent across the board, which is pretty close to the level of compression we saw in the financial crisis, and other past recessions, except it usually takes a few years, and this time around it has happened in a few months. And look, when it comes to this stuff, there is a ton of evidence that basically nobody gets it right consistently, and that is because macro is not something that can be directly tied to a repeatable process the way bottoms up investing can. And I am mostly of the view that if there are two Nobel Prize winning economists that are arguing against each other on things like interest rates and inflation, and they can't figure out who is right, I am unlikely to be the straw that tips the scales one way or another. I am however strongly of the view that we should include an understanding of how our businesses will perform through difficult periods as part of my base investment process, and be prepared for whatever might come, and that means good businesses, good people, good valuations, good medium term outlooks, and being prepared for bad periods. Beyond that I am of the view that the most value can be added by being aware of expectations. And right now, expectations are really bad.

Three Minutes on Macro

The next few years are likely to be more challenging than the last few years.

- Inflation
- Interest rates
- Recession
- Expectations
  - 92% of fund managers expect earnings to drop in2023
  - Record high number of fund managers underweight equities
  - Record high number of investors overweight cash
  - Record high put options purchased
  - Record high number of index futures short

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Slide 25 – Three Minutes on Macro - Expectations

A recent survey from B of A said that 92% of fund managers expect earnings to drop in 2023. That is the highest level on record. And a record high number of fund managers are underweight equities. A record number of put options have been bought, and a record number of index futures are short. And a record number of investors are overweight cash. September was the worst month since March of 2020 when Covid first really hit. Global free cash flow yields are north of five percent. They were at two percent in 2007. And at some point that kind of activity just starts to suggest that the problems we are facing with inflation and interest rates and recession are going to last forever. And I just don't think they will.

In fact, there are signs inflation is starting to flag, and equally – or perhaps more importantly, the surveys of inflation expectations are clearly coming down. Interest rate coverage for U.S. companies is still at all time highs, and maturities have been pushed out. Global net debt to EBITDA is at something like one X. It

was at five X back in 2007 before the financial crisis. So there seems to be a lot of cushion. And I'm not interested in trying to call the top of inflation, or to call the level that rates will even out at. I think those are fool's errands. But what I can say with confidence is that if you wait for peak inflation, or wait for rates to come down, it is likely to be too late. There is a lot of evidence to support that. Both at the macro level, and of course at the micro level, with the Capital One example from earlier. The second and third derivatives show up before anyone looking at the headlines realizes it, and the market figures it out. And that is especially true with interest rates. I think there is a strong case to be made that the problem with rates right now is not the absolute level, but rather the lack of certainty and the rate of change. And once rates stabilize – even if they stabilize at higher levels than we have seen in a decade – I think the market will be ok – there will be an adjustment period of course - and I think good businesses led by good people that are improving their earnings power will be better than ok.

And the consumer is still in great shape. Credit card delinquencies are still falling, and would have to go up three hundred or four hundred basis points just to get to where they were in 2007.

So can it get worse? Yes of course. Is it already really bad? Yes, it is. But going back to the fundamental building blocks that we talked about earlier, one of the two things that ensures successful investing is a positive shift in sentiment, and the more negative it is today – and it is very negative today – the more that positive shift matters when it eventually comes. And another thing to think about is that small cap stocks – where we play – are historically cheap at the moment. We talked about this earlier, but again I wouldn't say the same for large caps necessarily, but small caps are at something like ten and half times forward earnings, and large caps are still something like sixteen times, and small caps relative to large caps are two standard deviations below large caps. That is inline with the Covid low, and the only time it was lower was coming out of the tech bubble. And that is including small caps without earnings, and historically small caps usually trade at a premium, but right now they're at a severe discount. And look, I understand the problem with forward earnings. The problem is that they can get cut. So yes, maybe forward earnings for small caps get cut, but when you're at ten X forward earnings you can cut quite a bit and still be cheap. And if you look at the tech bubble, if you look at the financial crisis, small caps led large caps by something like forty percent over the three years following the turn.

So look, I don't know what is going to happen next with the macro, and neither does anybody else, although the broken clocks will be right, and someone will be crowned the next great prognosticator by the financial media, but we should not worry about that. We should worry about the fundamental building blocks of success, which are improving earnings power, and improving sentiment. And I think the specific businesses we own are very well positioned to improve their earnings power, and I think broadly speaking the skew on sentiment right now is very favorable. It can get worse in the near term. But if you invest with a three to five year view, you have to see the positives. And I think we are in great shape looking out a few years, regardless of what happens with the macro in the near term.

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You can only control process.

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…even if it doesn't work all the time

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- Temporary problems
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- Patience. This too will pass.

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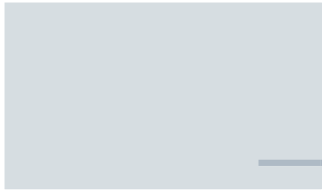
Slide 25 – The Best Path Forward

And I think the best path forward is to do what I have always done. Just stick to the process that has brought us our past success. It is hard day to day in the market right now, but if you zoom out I think our businesses will greatly increase their earnings power, and sentiment is so negative right now, that at some point it will get better, and we will be rewarded. And if I am being honest, I think it is easier to see a path to normalcy right now than it was just two or almost three years ago when we were first dealing with Covid. At some point, the world will be normal again, and I think we will be very well rewarded.

Questions?



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Slide 26 – Questions

So, that is it for what I had prepared. I apologize. I talked a lot longer than I planned too. I just get excited with all of this stuff. I think there are a lot of exciting opportunities, so I tend to ramble. Lets move to questions though – and I would ask that you keep them high level. If you have more granular questions on some of our investments – or even better, if you think I am wrong about some of our investments, I really want to hear about that – but lets keep it high level for now to help me preserve my independence of thought and fight the commitment and consistency bias that comes from a public forum like this so it will be easier to change my mind if I need too. Anything more granular maybe we take off line and I'd be happy to chat. So if there are any questions, please go ahead.

Question: Are there things you have sold out of, and maybe bought back, around tax losses, or for other reasons? And then, how do you think about some of the names that have been around a while. It doesn't seem like there has been all that much change in the portfolio?

Yes for selling and buying back. The big one there is Avid Bioservices, which I wrote about in the last letter. I think we sold that in Q four of 2021, and then again in the last letter I talked about how I had bought it back. And basically, when we sold it it was in the low thirties, and that was pricing in a bright future. And then we were able to buy it back around twelve to maybe fourteen. And that's a big change in price, but the business really hasn't changed. In fact, maybe it has gotten better. I think I mentioned earlier about Regeneron, and their comments on the demand picture, where they expect demand for biologics to triple in the next few years as all of these biologic drugs roll off patent, and the biosimilars roll on. And then more broadly something like half of all new drug applications are for biologics these days, and there just

isn't enough capacity to manufacture them all, but that one was really just about the valuation. There have been others where I have sold, or partially sold and then waited thirty or thirty one days to buy them back to capture the tax loss, and that is something I try to be conscious of. A good one there is Countryside, where I was able to sell shares, but also buy Vistry, so that our exposure was basically the same, but we are able to take the loss. So, again, that is something I try to be conscious of.

As for changes in the portfolio, I mean, yes, there are a lot of names that should be familiar. Remember, I am starting out with three to five year theses. And if its only been a year, just because the stock is down doesn't mean the story has changed. It takes time for the kind of fundamental change I am looking for. So I try to stay flexible, and I want to always of course upgrade the portfolio, and there are some new names like HGV and Griffon and some smaller ones we didn't talk about, but if we're only one year into a three or five year thesis, price by itself isn't necessarily a reason to sell.

And I talked about HGV earlier, but Griffon is kind of a funny story. I first did work on Griffon in 2013, when I was working for someone else. And I spent about a month on it, and wrote like a thirty page report on it, and I went to my boss and told him they have some good businesses, but it's this outdated conglomerate structure, and the management team is way overpaying themselves, and someone should go in there and shake things up because there is a lot of value. And he turned around and said, "oh yeah, I know the CEO. He's actually on the board of directors for my mutual fund." And that was the end of that. And then I have kind of just loosely been aware of it, and then more recently an activist came in and started demanding change, and they sold one business off, and they're in the process of selling another, and you can kind of look at that one business and recent comp transactions, and see that the sum of the parts is way bigger than the enterprise value, and they are actively unlocking that value, and I think they will get the cost structure inline. So that maybe doesn't have as much multi-year upside as some of the other names I have been buying, but the timeline should be shorter and the story is cleaner, and I want to have some of those kinds of bets too.

Question: Is there anything that has changed with your underwriting process with the change in interest rates? And how are you thinking about terminal values in a higher rate world?

Yes – the world has changed. So my base process has always been looking for three to five year doubles at a minimum, which sort of implies like fifteen percent to twenty six percent CAGRs. And these days, I am more selective. For example, like HGV which I talked about a little bit. I think that could be up three to five times in five years, so the bar to get into the portfolio is higher. But there is also a portfolio management component. Like CDMO for example. When I was buying that at twelve or whatever, I thought it could triple in maybe two or three years. But its moved up quite a bit, so now maybe its only a double. But I also try to stay aware of how it fits in the portfolio. Obviously something that could be up five X is more attractive than something that can double on the surface. But at the same time, a name like CDMO has some defensive elements because it is healthcare, right? And the balance sheet is clean with a bunch of cash on it. And from a portfolio level I want some things like that in there because it is more defensive and presumably won't sell off as much in the event there is another leg down. And then maybe that is a source of cash later if other stocks get much cheaper if that makes sense.

As for terminal values, yes, definitely, in a higher interest rate world, the right thing to do is be more conservative with exit multiples. But for me, I always include a range of potential exit multiples in my

thought process. And remember, the core of the thesis is about changing earnings power, not multiples. So if you have a change in earnings power, even if you don't get the multiple, you should still do well. So if a year or two ago I was thinking that a name might be worth twenty or twenty five X, maybe today its only fifteen or twenty X. But who knows? If you look at the data around inflation expectations, you can see that five year forward expectations are like two and a half percent. So if that is the case five years from now, maybe interest rates are lower again, and then twenty to twenty five X is the right range. We'll figure that out a few years from now, but the real thing is just that getting the change to earnings power right is more important than getting the multiple right, as long as we don't overpay. That is part of the margin of safety. If the earnings power is higher a few years from now, we will do well even if the multiple is flat. So if I think we're buying things at like four or five times free cash flow looking out a few years, like HGV, or Vistry, or APG too, the multiple is less important. If I'm even a little bit right on how earnings power can grow, we will do fine. And if the multiple is twenty X that's great. But if its fifteen X, that's better than a stick in the eye. We will still do well. So I always consider a range of multiples, but I am erring on the side of caution these days and the bar to get in the portfolio is definitely higher because there are a lot of cheap stocks assuming you can be patient and look out a few years.

Question: Can you provide an update on CDMO and Landec.

So CDMO and Landec I wrote about in the last letter, and there isn't much that has changed, except what I mentioned earlier about positive commentary out of Regeneron on the demand for biologics and biosimilars in the years to come. And I think these two are very well set up, and I think they're mostly recession proof. That isn't entirely true though. There is a part of the business tied to new drug development, and presumably the fundraising environment for early stage biotech is harder now. But it should be a year two before that becomes an issue because everyone raised as much as they could over the last few years. The other piece of it is that there is a natural die off of these businesses. Like if they come to Avid for process development work and then hopefully phase one and phase two etc. But some of them won't make it. And those that do make it will have a better chance at fundraising of course. And the other piece again with Regeneron – there is just a lot of demand coming. And there has also been a lot of supply built, but most of that is overseas and twenty thousand liter where CDMO is more two thousand liter, and is domestic. And the twenty thousand makes more sense for these blockbuster drugs – the original drugs which are now rolling off patent. But for the generics – the biosimilars – the small capacity might make more sense. Like I know one of the big drugs that has seven people approved for biosimilars. And if you're the only game in town, then twenty thousand makes sense. But if you are competing against seven other people – the original and then six generics, the two thousand probably makes more sense. And the other thing to think about is that CDMO has guided to one hundred fifty million or so in revenue this fiscal year. And by next summer they should have something like three hundred seventy to four hundred million dollars in capacity. And it is rare to build on spec in this industry. They probably have a good handle on who is taking most of that capacity. And you can look in the past, at times when they would announce another fifty million of capacity was coming online, and then the backlog jumped by forty million or something close. Because there are literally people knocking on the door saying we need capacity. And that won't last forever. When I talk with them, I try to always stress that every industry in growth mode eventually adds too much capacity. And I think they get it, but we'll see. Human nature does not have a good track record in these situations. People like to build. Anyway, if

they fill the four hundred million in capacity that's great. But if they fall short, and they only double their revenue from one hundred fifty to three hundred million, we'll do fine. Four hundred million is better, but again, a doubling is better than a stick in the eye. That is part of the margin of safety. But maybe they do get to four hundred million. Then what? Maybe they start buying back a ton of stock, or maybe they keep growing. On a call just a few days ago they were talking about maybe adding some east coast capacity at some point. And that probably makes sense at some point – depending on the industry – but one of the risks here for any pharma company is supply chain risk. And for CDMO, I mean, they are in California. If there is a big earthquake and California falls into the Pacific, we have a problem. As do all businesses based in California. So maybe it makes sense to build more on the east coast so customers can diversify that risk. We'll see in a few years I guess.

As for Landec – its similar, but its different. So Avid has a fully funded balance sheet. Landec does not, so it is a smaller position. Landec also has more moving pieces. They have this avocado business, which they have been trying to sell for awhile. And I think the way to think about it is put a value on the avocado business, and deduct that cash from the debt, because they have been open about paying down debt. And then put a multiple on Lifecore – that is the CDMO part of the business – put a multiple on Lifecore and compare it to the adjusted EV pro forma for the sale of the avocado business. And that's very easy in a spread sheet, but in the real world it has been a lot harder. In the beginning of 2021 avocados sold for like twenty dollars a crate. And as of a few months ago, they were selling for like eighty dollars a crate. They've come down a bit, but its just not possible to push through that much inflation that fast. So selling the business has been taking longer than hoped for, although they did just yesterday say they hoped to have a sale by year end. So that part is hard right now. And the business still screens as a food company, so anyone who is looking at this sees a food company that is dealing with three hundred percent inflation and is losing money.

But the CDMO business is different. So I talked earlier about all this demand for biologic drugs. And most biologics are injected. And Lifecore basically does fill finish for injectables. Like prefilled syringes. And then they also are one of only two players globally that can make hyaluronic acid at scale. And hyaluronic acid is basically like the delivery mechanism for the active pharmaceutical ingredient. It is desirable because it is naturally occurring in the human body. You can kind of think of it as floating or suspending the drug in the hyaluronic acid and then injecting it. And if you are a pharmaceutical company looking for someone to do the fill finish work for you, you can decide do you want to go with a CDMO partner that has to then source their hyaluronic acid? Or do you want to go with a CDMO partner that has HA in house? And I think that is a real advantage. It just makes a ton of sense in terms of keeping the supply chain simple. The other thing to think about is that there is a real long lead time on the equipment involved here. Like Landec starting planning their current expansion in 2018 or 2019 because there are very few suppliers of the equipment, and normal lead times are like three years, and then Covid pushed everything out. And the industry has all this demand coming, but unless you started planning four years ago, you can't expand capacity. So Landec is in position to double capacity in the relatively near term. But it is the worst kept secret in the industry that someone is probably going to want to just buy Lifecore rather than waiting four years to build from scratch because they just need the capacity to meet all this demand. But right now, the sale of the avocado business has not been as easy as I hoped, and no one is buying Lifecore and the avocado business together. They need to be split up. The other things to think about though are around perception. Landec is about to go on a non-deal roadshow with Stephens, who has a good analyst in the space. And they're formally changing their name to Lifecore, and then they won't screen as an avocado

company any more. And then they're going to JP Morgan's health care conference in January, which is the biggest health care conference. And those things will help awareness. And help perception. Most of the market still thinks this is a packaged food business, but its not.

But still i kind of look at it as you have to punish them for the avocado business. They bought it a few years ago for eighty million, but maybe its not worth that anymore. I have always penciled in like sixty or 70 million dollars. And you can look at their debt covenants and say that they will still be well within range even if they get a lower price for avocados. But the reality is there is a wide range of outcomes. But even in the downside cases I think you can still get to like fourteen bucks a share, and the stock is at eight or nine. If things go better with avocados, and a strategic really wants these fill finish assets, then I think you can get to high teens or twenties. And that's not just me by the way. That is industry people I have talked to who think these are really good assets and someone is going to want them or even need them because the lead time is so long. So we'll see. Things can go wrong. But I don't think recession is one of the things to worry about.

Question: Can you talk about FREE

FREE is Whole Earth Brands. And I think I wrote about this in the last letter, but they have painted themselves into a corner a bit because they told the world they were a growth story, but now they don't have the balance sheet or the equity cost of capital to really grow. They can still grow faster than other food company peers. If you think of packaged foods in general you kind of think of inflation level growth. Well, actually, that was historically. Now with inflation where it is it is different. But historically you kind of think of growth in packaged food land as maybe two or three percent, and Whole Earth has shown they can grow faster organically, because they are on the right side of the trend toward better for you ingredients, and natural sweeteners. But they are levered. They have a lot of debt, and the market does not like debt right now. And another thing to think about, a lot of their products are at premium price points. And that isn't really where you want to be during a downturn, because people trade down. But at the same time, they are still adding SKUs, and getting into new doors, so maybe that growth offsets whatever trade down affect there might be. But at the same time, they are trading at four or five times free cash flow right now. So it used to be a mid sized position, and now it is like a two percent position. But I have room for stuff like that in the portfolio because if you look at slower growing peers, they trade at like twenty or twenty two times free cash flow, and you have seasoned operators here who I think can figure it out. One of the interesting things is that Martin Franklin – who is a capital allocator I have a lot of respect for – just recently put his son on the board, and he owns like fifteen percent of the company. And while I am generally not a fan of nepotism, I think this is probably ok, because Martin Franklin got his start when his own father put him on a board at a young age, and then Martin Franklin went on to make a ton of money for people. The chairman here is Irwin Simon, and the last time Franklin and Simon were together was at Jarden, where they compounded at twenty or almost thirty percent a year for a long time. So it doesn't fit in the model, but I don't think Martin Franklin puts his son on a board where he thinks it is going to fail for his first board job. And again, these are seasoned operators. I think they can figure out the capital structure, but its going to take time. They have another business – a licorice extract business – and maybe they sell that to repair the balance sheet a bit. But again, its at four or five times current free cash flow, growing mid to high single digits, there is some room to widen margins. That kind of set up can lead to very good returns when comps often trade north of twenty times. So it is still a small position.

Question: How do you think of the value of Aimia and the businesses they own?

So we still own Aimia, but it is a smaller position now. And I think its very cheap. I mean its trading below the cash they have, so I think it would be very hard to lose money. But at the same time, if you look at history, things that are just very cheap don't do as well coming out of a downturn as real businesses with cash flows. And I think this will turn into more of a real business with time. But Ben Graham did some work on this, and Mohnish Pabrai and others have done work on this, and if you own net nets and discounts to cash, they just don't get the juice coming out of a downturn that cash flow stories get. There is also some internal uncertainty. There were two brothers that were both kind of supposed to be running this. But now we're down to one brother. And I think he's going to be great. I have gotten to know him a bit personally, and he's one of these guys that never stops thinking about deals, and I think he's going to create a lot of value with time. But right now owning cash flow just seems like the better place to be given where we are in the world.

As for what they own, I mean, I think they have some stuff that is going to be very valuable, and some stuff that is not very exciting. And to be fair, they inherited the lower quality stuff for the most part. But one of the things they own is a piece of Clear Media, which is kind of how I got involved in this. Clear Media is the largest owner of bus panel advertising in China, and it was public, and we owned it, and then Aimia was part of a group that took it private. Now bus panel advertising doesn't sound great, but if you think about it, it is actually valuable real estate. So much of advertising these days is easy to avoid. You get a pop up on your phone, you close it. There is a commercial on TV that you DVR'd, and you fast forward. So out of home, or OOH advertising is actually a good place to be because you can't X out of it. And the math is pretty simple. You can look at the number of bus panels they have, and put a revenue number on them, and a margin on that, and you can see where you are going. And I don't remember exactly, but I think when they took it private they had maybe forty thousand and change bus panels in China, and now I think its closer to sixty thousand. Or it will be soon. But China has still been locked down. And then the other thing to think about is historically these were almost all like poster boards. And you had to have a person go to all the bus panels, and swap out the poster board once a month or whatever. And now they are investing in digital, which is just much better. I mean, instead of selling a bus panel one time, now you can sell it maybe six times, and then the advertisement changes every couple minutes or whatever. And instead of having a guy going and replacing the poster board, maybe you can update remotely. And the problem was that Clear Channel Outdoor, which is public here in the U.S., owned like fifty percent of the equity, and Clear Channel was levered six or seven times, so they had Clear Media dividend up all the cash flows so Clear Channel could service their debt. But because of that they were not investing in digital. But now Aimia and the rest of the ownership group is doing that. And I think they invested seventy five million in this, and they got a good price because Clear Channel was kind of a forced seller because they had to pay down their debt, and I think its not that hard to say this is going to be worth two hundred million or more for Aimia looking out a bit. And then they own some other things that I think will be ok. Some of them better than ok. And I know they see a lot of deal flow with their cash pile, and I don't know what they're going to do, but I know they are excited. It will be something cash flowing. And the guys running the show have been studying holding company structures for more than twenty years, and they have views on what works and what doesn't. But all of that is going to take time for the market to figure out, and again, coming out of downturns net nets and discount to cash stories just tend to not

do as well as cheap cash flows, so I sold a lot of our position. And there were some tax considerations there too.

Anyone else?

OK, if there aren't any more questions, I guess we can wrap it up. If you do have other questions, or if you think of something else, please feel free to reach out to me. Email is usually best and then we can set up a call. But I am happy to talk. It has been tough out there lately, and knowing what you own can only help. So thank you again to everyone for joining today. I think we are going to do well with time. I am excited about what we own looking out a few years. So thank you again, and take care.

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