

Fairlight Alpha Fund LP

Q2 2022 Letter

Dear Partners,

Fairlight Alpha Fund’s second quarter 2022 returns were 7.9% net of fees. This compares to -16.1% for the S&P 500 Total Return index. In the year-to-date 2022 we have returned -10.6%, compared to -20.0% for the S&P 500. Overall, since inception the fund has returned 284.4% net of fees and 49.7% on an annualized basis. Relatively our outperformance this year has been good, but not as good as we would like on an absolute return basis.

Performance vs. the S&P 500

We track the net asset value of Fairlight Alpha Fund (the “Fund”) over time as calculated by our fund administrator based on our portfolio positions and prices over time on a dollar basis. The fund financials are also audited each year by an independent auditor with the assistance of the Fairlight management company and the fund administrator.

The tables below show the S&P 500 total return and partnership net returns, after fees, for each year 2019-2021, and for the year-to-date 2022, followed by the compounded returns over the same period, as well as the annualized gains.

Annual Returns

<u>Year</u>	<u>Fairlight Alpha Fund</u>	<u>S&P 500 (Total Return)</u>	<u>Difference</u>
2019 ¹	38.1%	17.9%	20.1%
2020	26.3%	18.4%	7.9%
2021	146.5%	28.7%	117.8%
2022 (YTD)	-10.6%	-20.0%	9.4%

Compounded Returns

<u>Year</u>	<u>Fairlight Alpha Fund</u>	<u>S&P 500 (Total Return)</u>	<u>Difference</u>
2019 ¹	38.1%	17.9%	20.1%
2020	74.4%	39.6%	34.7%
2021	329.9%	79.7%	250.2%
2022 (YTD)	284.4%	43.9%	240.5%
Annualized Gain	49.7%	11.5%	38.2%

(1) The S&P 500 returns represent the total return index, i.e., with dividend reinvestment included. Increases in value arise from stock price appreciation as well as dividend reinvestment. This provides a fairer comparison to the fund.

(2) The Fairlight Alpha Fund performance is shown net of partnership fees and expenses.

¹ The Fairlight Alpha Fund was launched on 01-Mar-2019 and so the 2019 performance and any returns are presented for a 10-month period.

Although the fund outperformed the S&P 500 across Q1 and Q2, the results were still negative being affected by bear market headwinds. We discuss our performance and market conditions in more detail in the following sections.

Current Market Conditions

The market has now entered a new phase with the excesses of 2021 being corrected during this downturn. For the first half of the year the process has been one of multiple compression and for the second half of the year it remains to be seen how much earnings compression occurs, as the effects of inflation and costs begin to hit corporate earnings and pricing pressures take their toll on consumers.

The Web3 Bubble

Many people compare the Web3 boom and bust with the dot-com era. Back in 1999 during the dot-com boom, analysts at major Investment Banks (naming no names) were heard to refer to stocks by ticker rather than name, but in that cycle, they knew what the businesses did. This contrasts with today where complex AI modelling and extremely technical cryptocurrency white papers make the businesses proposition opaque to investors. This time may not be better or worse than the dot-com bear market, just different.

In the 1998-2000 era, as now, there was lots of hype. That boom was primarily driven by the internet, as the adoption of the world wide web spread into online shopping, new communication technologies and news sources. The bubble eventually spread to the wider biotech and technology sectors. In the boom there were many frenzies and excessive valuations, adding “.com” to company names would change valuations overnight and the NASDAQ 100 index PE rose into the 100s in late 1999.

After the bubble burst, the 2000-2002 bear market began, with the mood turning sour much like today. The tech euphoria turned to depression, and market commentators attempted to determine which companies would survive and thrive and which ones would not. Would it be Amazon, Yahoo!, Google or AOL? These answers were not obvious then. Amazon was “just” an online book seller and Google was “just” a search engine web page. How would Google ever make money out of its many search engine users? And would Amazon ever turn a profit, having grown revenue rapidly for several years? Some thought Amazon would not be profitable for over a decade if ever. They were eventually proven wrong when Amazon earned a modest profit of \$35 Million for full year 2003. The internet had entered the “Slope of Enlightenment” phase of the hype curve². Similar questions can be asked today. Who wins out of Bitcoin, Ethereum or Cardano? Will NFTs survive as a market? Which companies will succeed ultimately, if any, out of Peloton, Carvana, Tesla, and Zoom?

The bear market has lasted for 189 days as of the date of this letter and fallen by 19.6% from the peak³. How much longer will it last and how far will it go? There may also be crashes or corrections and recoveries along the way. These are very difficult questions to answer, but it feels to us that there are still negative forces acting on the market. The full effect of inflation on the market and its trajectory is still uncertain. It seems that it will fall back from a peak, but to what level and how long will it persist at levels above the Fed’s inflation target or the rate of inflation that the FOMC believes is most consistent with stable prices?

² It certainly doesn’t feel like we are “Running Up That Hill” just yet in 2022.

³ As measured by the S&P 500 index using daily close data (adjusted for splits).

Our Investment Approach

Given all the uncertainty, how best to invest and structure a portfolio in such a market? We have a heavily detailed approach, akin to the scientific method, for studying businesses and their moving parts. What makes a business tick? What drives the numbers in the lines of the financial statements? Where is the business now and where is it likely to be 1-3 years out? Counterintuitively perhaps, this is easier to predict and estimate than the future of the macro-economic global landscape from this point. We aim to build a portfolio of businesses generating high cashflows relative to valuation, growing with low capital requirements. Finding companies like these we should do well in the long term.

Further to this, as the market revalues, particularly in the US at the moment, we are beginning to see some pockets where attractive valuations and good investment ideas are appearing. We repeatedly scour the whole world for ideas, recently finding more ideas in East Asia than in the US, but this is beginning to change. As relative valuations and business conditions change, we will re-evaluate and rotate the portfolio to take advantage of any changes.

Our Performance to Date in 2022

While market prices for the businesses we own were down in the first half of 2022, operational results are higher relative to 2021. We focus on the latter knowing that over time the former will follow as long as we buy and hold reasonably intelligently. In 2021, we benefited from the twin tailwinds of improving operating results and rapidly rising investor expectations. The net effect of this was our holdings revalued from ridiculously cheap to moderately cheap. As valuations change across the portfolio and across the market, we use a proprietary “look-through” methodology to continually optimize the portfolio. This uses metrics based on our owner’s share of earnings, or cashflow for owners (similar to Buffett’s owners earnings concept), and other measure such as cash balances and dividend distributions.

An example of this progression through the valuation journey is Azeus Systems Holdings Ltd. (SGX: BBW). When we first bought the shares between SG \$1.00 and SG \$2.00, the valuation was extremely compelling. Prices rose rapidly in 2021 as the market began to recognize Azeus’s outstanding business performance. Over the last six months, however, the market for BBW has been consolidating as some investors are realizing gains and no large new buyers have purchased shares. So, what has happened to the business during this time? In March, Azeus appointed a new CEO and executive Managing Director to lead growth, announced the biggest contract in the corporation’s history (which will lead to 70%+ growth in recurring products revenue), has continued to hire new software developers, and is doing a fantastic job building out its sales and marketing team. While the shares are up from our purchase price, the business fundamentals are also up considerably.

This is the case across our holdings. Business operations are better than six months ago. The only thing that has changed is investors’ expectations. Our expectations, however, have not changed. Economic activity in 2-3 years (needless to say 10 years) will be higher than 2022. Our belief is time in the market trumps timing the market and we focus on the long-term fundamentals. Here we are confident our businesses, in aggregate, will be better off than today, and as time passes businesses will go from moderately cheap back to ridiculously cheap as business value increases.

The best part of a falling market is being able to reallocate funds to better bargains. We have found a very attractive opportunity in the United States. We have been allocating some capital from Eastern markets back to the States because of this changing picture. The United States in our opinion still does not have the bargains it did five years ago but is getting closer to being more fairly valued, and things are getting more interesting due to intense selling in the first half of the year.

Market Performance Since Mid-2021

It is notable that there have been disparate movements in global markets. Some Asian and European markets have held up well, given that they did not go up as strongly as US markets which are down significantly in the last year, particularly the “tech-heavy” NASDAQ indexes.

Table 1: 12-Month Comparison of Global Stock Market Indexes vs. June 30, 2021

<u>Market</u>	<u>Jun 30, 2021</u>	<u>Dec 31, 2021</u>	<u>Change %</u>	<u>Jun 30, 2022</u>	<u>Change %</u>
S&P 500	4,298	4,766	10.9%	3,785	-11.9%
DJIA	34,503	36,338	5.3%	30,775	-10.8%
NASDAQ Comp	14,504	15,645	7.9%	11,029	-24.0%
FTSE 100	7,038	7,385	4.9%	7,169	1.9%
DAX	15,531	15,885	2.3%	12,784	-17.7%
CAC 40	6,508	7,173	10.2%	5,923	-9.0%
SSE Comp	3,591	3,640	1.4%	3,399	-5.3%
Hang Seng	28,828	23,398	-18.8%	21,860	-24.2%
STI Singapore	3,130	3,124	-0.2%	3,102	-0.9%

As at the end of 2021 the US markets were near their peak and had mostly outperformed the Asian and European markets shown here. Of particular note the Hang Seng had fallen at a similar time to many US “meme” stocks from mid-2021 to the end of the year. This picture changed dramatically in the first half of 2022 with US markets falling, in the case of the NASDAQ Composite to the same level as the Hang Seng. The UK, Chinese and Singapore markets have held up well to this point.

Another interesting side note is that the STI Singapore index is the most illiquid market in the above table. Most individual investors would probably benefit from less liquid markets as they would have less opportunity to buy in at the top and sell at the bottom. Some stocks trade like PE investments, that forces investors to think more about the businesses in which they are investing.

This highlights to us the importance of being global and nimble across markets, using valuations alongside growth and quality metrics. This top-down macro picture mirrors what we find through our bottom-up analysis of stocks across the globe. We find many good businesses in all countries and many sectors, but many times the valuation precludes us from investing in stocks in certain markets. The United States had become priced out of reach until recently. But we have now seen some very interesting situations, particularly in the US community banking sub-sector which we will discuss further in future letters.

Outlook for the Remainder of 2022


The performance for the rest of the year for us will be dependent on the reaction of the market to idiosyncratic events in great businesses in East Asia, to new positions built in the US and related subsequent events. Some of these names have potential news events that will occur akin to special situations that could cause them to revalue rapidly, but we will aim to build and maintain large positions before this occurs.

We continue to find new ideas as markets correct and we will invest and rotate the portfolio applying our look-through approach and metrics. We are happy to welcome new partners to join the fund alongside us and look forward to deploying capital in the new ideas that we have.

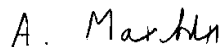
To the existing partners we would like to thank you for your continuing support and entrusting us with the management of your capital. We look forward to improving our performance in the coming quarters. We hope everyone has a successful remainder of the year, and finally to sum up:

“It is only in a bear market that the value investing discipline becomes especially important because value investing, virtually alone among strategies, gives you exposure to the upside with limited downside risk.” — Seth Klarman

Yours,



Chief Investment Officer: Nick Peters
Email: nickp@fairlightcapital.com



Chief Executive Officer: Andrew Martin
Email: andrewm@fairlightcapital.com

Fairlight Capital LLC,
500, West Putnam Avenue
Greenwich, CT 06830
203-542-7325 | info@fairlightcapital.com

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AN INVESTMENT IN THE FUNDS IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. OPPORTUNITIES FOR WITHDRAWAL, REDEMPTION AND TRANSFERABILITY OF INTERESTS ARE RESTRICTED, SO INVESTORS MAY NOT HAVE ACCESS TO CAPITAL WHEN IT IS NEEDED. THERE IS NO SECONDARY MARKET FOR THE INTERESTS AND NONE IS EXPECTED TO DEVELOP.

THE FEES AND EXPENSES CHARGED IN CONNECTION WITH THIS INVESTMENT MAY BE HIGHER THAN THE FEES AND EXPENSES OF OTHER INVESTMENT ALTERNATIVES AND MAY OFFSET PROFITS. NO ASSURANCE CAN BE GIVEN THAT THE INVESTMENT OBJECTIVE WILL BE ACHIEVED OR THAT AN INVESTOR WILL RECEIVE A RETURN OF ALL OR PART OF HIS OR HER INVESTMENT. INVESTMENT RESULTS MAY VARY SUBSTANTIALLY OVER ANY GIVEN TIME PERIOD.

THE PERFORMANCE DATA SHOWN HEREIN REPRESENTS THE PERFORMANCE OF THE FUND. THE RESULTS REFLECT THE DEDUCTION OF: (I) AN ANNUAL ASSET MANAGEMENT FEE OF 2%, CHARGED QUARTERLY; (II) A PERFORMANCE ALLOCATION OF 20%, TAKEN QUARTERLY, SUBJECT TO A “HIGH WATER MARK;” AND (III) TRANSACTION FEES AND OTHER EXPENSES ACTUALLY INCURRED BY THE FUND. THE RESULTS REFLECT THE IMPLEMENTATION OF THE INVESTMENT STRATEGY DESCRIBED IN THE FUNDS’ OFFERING DOCUMENTS AND APPLIED IN THE FUNDS’ TRADING ACCOUNTS. ALL INVESTMENTS INVOLVE RISK, INCLUDING THE LOSS OF PRINCIPAL.

RESULTS ARE COMPARED TO THE PERFORMANCE OF THE S&P 500 TOTAL RETURN INDEX (THE “COMPARATIVE INDEX”) FOR INFORMATIONAL PURPOSES ONLY. THE FUND’S INVESTMENT PROGRAM DOES NOT MIRROR THE COMPARATIVE INDEX AND THE VOLATILITY OF THE FUND’S INVESTMENT PROGRAM MAY BE MATERIALLY DIFFERENT FROM THAT OF THE COMPARATIVE INDEX. THE SECURITIES OR OTHER INSTRUMENTS INCLUDED IN THE COMPARATIVE INDEX ARE NOT NECESSARILY INCLUDED IN THE FUND’S INVESTMENT PROGRAM AND CRITERIA FOR INCLUSION IN THE COMPARATIVE INDEX ARE DIFFERENT THAN THOSE FOR INVESTMENT BY THE FUND. THE PERFORMANCE OF THE COMPARATIVE INDEX WAS OBTAINED FROM PUBLISHED SOURCES BELIEVED TO BE RELIABLE, BUT WHICH ARE NOT WARRANTED AS TO ACCURACY OR COMPLETENESS. UNLESS NOTED OTHERWISE, THE RETURNS OF THE COMPARATIVE INDEX PRESENTED HEREIN DO NOT REFLECT FEES OR TRANSACTION COSTS, BUT THOSE RETURNS DO REFLECT NET DIVIDENDS, IF ANY.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.