

Fairlight Alpha Fund LP

Q1 2024 Letter

Dear Partners,

Fairlight Alpha Fund's first quarter 2024 returns were 14.5% net of fees. This compares to 10.6% for the S&P 500 Total Return index. Overall, since inception the fund has returned 509.5% net of fees and 42.6% on an annualized 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 2019-2023, 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	15.8%	-18.1%	33.9%
2023	6.9%	26.3%	-19.4%
2024 (YTD)	14.5%	10.6%	4.0%

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	397.9%	47.2%	350.7%
2023	432.2%	85.9%	346.4%
2024 (YTD)	509.5%	105.5%	404.0%
Annualized Gain	42.6%	15.2%	27.4%

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

- (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.

The fund exceeded the positive return for the S&P 500 (Total Return) for the first quarter. We aim to exceed this benchmark so that even during market retreats we are able to obtain a positive return over a statistically long enough period. In this letter we will discuss some of our current thoughts around our strategy and investment approach, and additionally insights into the factors driving our current performance.

Market and Portfolio Performance

Since the last letter the macro and geopolitical environment has become arguably more uncertain than before, but it seems that in each quarterly letter there is always something uncertain on the horizon. However, one of the most helpful elements of being a bottom-up investor, rather than a macro one, is that we don't have to estimate (or guess) what will happen to oil prices, gold prices, interest rates, currency fluctuations, real estate, or the general level of the market. Rather than this we have a universe of over 70,000 stocks to search for value and growth. This is also not easy, but if one works hard it can provide more certainty.

Extending this point, the best ideas often have the least uncertainty. Some investments have what you could call a chain of uncertainty associated with them. For example, say Company A plans to launch a series of innovative products in a highly competitive market. The investment thesis could be that if these products satisfy or increase consumer appetite, then they will increase market penetration. This could provide more pricing power, but this would likely be contingent on being able to scale successfully, and prior to launch the cost structure for this additional product or service may not be known or be clearly estimated. Changes in competitors' behavior and consumer preferences, could also make the future outcome of a strategic shift uncertain. Thus there are a chain of ifs in this situation and while each may be estimated to have a high level probability of a successful outcome, chained together the outcome could be low. A simple example would be that $P(A|B)$ (the probability that A occurs given B has occurred) is 70% and $P(B|C)$, $P(C|D)$, $P(D|E)$ are also 70%, with A being the estimated return on the investment and E being the initial strategic catalyst. The probability of $P(A|E)$ is then only 24%. So a seemingly high probability chain of events will more often than not fail to occur.

The best ideas seem to be ones where E, the financial results from a strategic change, have already started to occur and they can be seen in the financial statements. And this will then in turn drive investment returns (A). This is the kind of investment we look for, where a strategic shift has occurred, it makes sense from a business perspective, and the results are already happening. Often in those circumstances they will continue to occur, the business will grow, and share prices will re-rate and follow the growth in the business itself.

Uncertainty also relates to the control investors and business owners have in any given situation. The Confidence Map by Peter Atwater is well worth a read in this regard² and outlines some very helpful situations and analogies for small investors, professional investors and allocators. In this book the author describes a quadrant with uncertainty along one side and control along the other. The axes are continuous, but are divided into quadrants: low certainty/low control, low certainty/high control, high certainty/low control, and high certainty/high control. Respectively these quadrants are labelled the "Stress Center", "Launch Pad", "Passenger Seat", and the "Comfort Zone". Many of us seek to

² See the post on X by Grant Williams, founder of Real Vision. His interviews are also well worth a look.

avoid the lower left Stress Center and aim to arrive at the Comfort Zone. But we may do that via the Launch Pad or the Passenger Seat by taking control or handing it off to someone else.

An investor can sit in various of these quadrants depending on their investments, market volatility and unknown information regarding investments. There is always some element of uncertainty, but this can be minimized and with the right tools control can be maintained to a certain extent, and the overall framework can help keep a logical perspective.

One aspect of this that occurs in some of the more hyped areas of the market (which we aim to avoid on the long side) relates to overtrading and short-termism. Shorter investing durations are likely to be driven by emotion rather than long-term fundamentals. And these can be instructive as what not to do. For example, many of the magnificent seven have pushed “liquidity” to a whole new level³. Although Elon Musk himself has a long-term vision across his various enterprises, including Artificial Intelligence strategy, multi-planetary species and societal openness, investor trading in Tesla stock shows a different picture. As of writing the daily volume in Tesla, Inc. common stock (TSLA) is so high that the entire market cap is traded every 28.7 days.

A Review of Specific Ideas

Getting back to the bottom-up view of the market, there are a lot of ideas around at the moment. Across the Americas, Europe, South East Asia, Australia there are a huge number of interesting companies and a lot of change in business, economies and technological opportunities. Some of these are AI or AI-adjacent businesses that can benefit from the huge, once-in-a-lifetime opportunities that are present currently. Although it seems incorrect to say once-in-a-lifetime, because in the last few decades we have seen the rise in personal computing, the creation of the internet and world-wide web, and now AI.

Referring back to the first two of these the internet has been a massive change to the world which is still evolving, and turning the way business is done on its head. Smaller companies and economies that would once have been held back by a lack of financial power, geographical location, or scale, can now compete on level terms with the largest. Small tech companies based in Eastern Europe (take your pick which one you think we are referring to!) can compete globally, in an efficient way, and grow rapidly across the world. There are many stocks and business models now that are seeing exceptionally high levels of growth that would have been difficult or less common previously without the underlying structure of the internet facilitating them.

Now it seems real and usable AI has been created, an idea which was science fiction just a few years ago, and this is likely to create a new wave of changes. It is likely we are in the very, very early stages of these changes. LLMs⁴ are evolving rapidly and are not near any kind of plateau yet. Leaving aside increasing model complexity, it might be tempting to think that these kinds of model have been trained on (or have read) almost everything written now, but techniques are improving to increase the “quality” of the training, and these models are only just beginning to learn from images, sound, and video. An interesting example of this is that current models can learn that yellow and blue pigments mixed produce green because they’ve read it, but may not have seen images relating to painting.

³ Perhaps these should be labelled as “gaseous” or “plasmatic stocks”!

⁴ Large Language Models like Chat GPT, Llama, Gemini and Claude. These were built to just predict the next word in a sequence, e.g. to build a response to a question. But it is now thought by some of their pioneers (such as Geoff Hinton) that in order to do that, these very complex models have learned to “understand” human language and concepts to an exceptionally high level.

Moving onto stocks there are two AI stocks we have either purchased or are investigating and many more candidates. Primarily these are AI-adjacent rather than businesses like Nvidia or Alphabet because the value in these evolving, smaller names is still being discovered. AI will need huge amounts of data and energy to function, as well as new infrastructure such as data centers. The use cases, and businesses relating to AI are still in their infancy, with cloud LLM services springing up constantly and the end game for robotics not yet clear. But as stated earlier, where the growth, financial results and profitability are already present in a company that is exceptional, and has better products, services, or works than competitors, these are the kinds of investments we are searching for.

But AI will likely affect every stock we own. For example, McCoy Global is already well positioned to benefit from data capture and increasing use of AI technologies in oil drilling processes. These systems will be much better able to make decisions about well completion and casing processes. We are also constantly reviewing existing business models, such as software to understand how AI may impact them. A disruptor could be an enabler in many cases making the production of software easier for software companies, but lowering the barriers to entry in other cases.

There are some sectors and ideas that are less AI related and may not be that strongly correlated. For example, there are some interesting ideas in the business of litigation finance we are investigating. These have a lower correlation with the market in general, but have some interesting payout characteristics. And, as for any ideas we mention here, we recommend the reader do their own research and build their own investment theses and conviction in any stocks mentioned.

Other ideas have appeared in a variety of different sectors which provide diversity. We are sector-agnostic, but it's a preferable accident if we manage to achieve some level of diversification across ideas. Some theses we are following or are invested in span sectors as diverse as healthcare, consumer goods, tech equipment and financials⁵.

The Meeting

Your boss calls a meeting and asks you to arrange it and get the conference room set up. Having worked at the company for two weeks, you immediately break into a cold sweat. At your previous tech start-up there was little in the way of infrastructure or support services and so you hope you made the right choice moving to this larger tech firm. But your new boss has only given you half an hour to get this done.

You head up to the conference suite level and place your laptop on the table. Racing through the meeting set up materials from the tech team you follow all the steps to the letter. Your laptop connects to the meeting room screen, you are able to share materials from your screen and you quickly search for the other meeting participants at the company HQ meeting room. Looking up at the clock you realize the meeting is about to start and your boss walks in, so you click to connect to the other meeting room.

The other participants appear on screen, but your laptop screen share disappears and the sound appears to be off. You see people in the other meeting room talking, smiling and pointing at the screen. Sweating and aware your boss has arrived, you frantically try and resolve what are now several technical issues. Aware this is a larger company you give up on calling tech support, who are in a completely different building. This situation may or may not be familiar, but is very common

⁵ We won't shout about some of these yet, in order to give us time to build the positions that we need, and learning from Ozymandias, we try to keep an eye to the timing of ideas and their lifecycle.

across companies which use a variety of technologies and stitched together solutions. For AV tech and conference calls, some of these work quite well, other less so.

Enter Cyviz AS, a small⁶ Norwegian tech company, that provides solutions for meeting rooms, command and control centers, innovation centers and operation centers. It's integrated seamlessly with MS Teams and has a simple Cyviz Easy Controller to control the screens and technology. This works in a similar way to an iPad or iPhone with a touch screen and simple controls. The controller is configured to work with the meeting room display, company laptops and allows easy access to directories for other staff and rooms. Once into a meeting, elements from laptops can be dragged, pinch/zoomed and moved around alongside video feeds and configured as required. Meeting setups can be stored so that repeat meetings can be recall instantly. Cyviz also has solutions for command and control and innovation hubs across many use cases with a product that works much better than competitors.

Firstly, let's highlight the negative aspects of the business, primarily being that this is not a pure software company with correspondingly ultra-high gross margins, but it does have very healthy margins for a part-hardware company. Also as we discussed earlier the product potential can be seen in the recent financial results, growing revenue at a rate of 35% annualized over the last 2 years, and with gross margins growing from 44% to 53% over that time. They have embedded Microsoft Teams into the product (Microsoft is also a client). They also have a growing number of blue chip, repeat order customers such as Accenture and Aker BP.

But this successful business has been rarely discussed or analyzed by investors, funds or analysts. The current price reflects this and based on our estimates is priced at 6x our estimate of EBITDA for the next year and P/S of 0.75x. For this company with a low level of debt (\$3.3m as of last quarter) the ratio to EBITDA is a helpful shorthand. And to emphasize the recent success of the company, in Q4 of 2023 they received a 169% increase in order intake versus the prior year. From our analysis this has a high correlation with revenue generation in the subsequent quarters and indicates that the next few quarters will be very successful for the company.

Current Outlook

In spite of uncertainty and volatility, or because of it, there are many opportunities in various markets. Smaller cap companies are still relatively undervalued compared to larger ones and this is just as measured by averages. There are always extremes in valuation in small pockets around the globe. Sometimes these exist in a single stock with an overlooked opportunity and valuation, other times a sub-sector or related group of companies will fall out of favor with The Market.

Thank you for reading this letter. We will try and continue to share our approach, ideas and thoughts. Do reach out if you are interested in receiving more information about us.

Yours,

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⁶ \$39.3 million market cap at the time of writing.



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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.