



July 31, 2018

Dear Partners,

Lightsail commenced operations on April 16 of this year. We're excited to begin, and honored to have you on board. As this is our first letter to you, we'd like to discuss why we created the partnership, how we are investing its capital, and what you can expect as a Limited Partner.

Our fund exists in order to grow our shared capital — safely, at a high rate of return, for as long as we can. We've designed the fund as a vehicle to manage our own wealth alongside that of like-minded partners who understand the power of long-term investing, and who recognize the value of the expertise we have built through 25 collective years spent researching and investing in small companies.

Our method is simple: We invest in growth at an *unreasonable* price. We look for young public companies bringing innovative and superior products to market. New product rollouts executed by young companies rarely go as expected, which creates a rich opportunity set for us. We buy when, and if, a company's growth trajectory is misunderstood by the market and the company has become exceptionally undervalued as a result. We focus on unit economics rather than consolidated profits, because what matters to us is how the business will look three to five years from now. Underlying all our decisions is a research process founded on bringing analytical rigor and intellectual horsepower to an inefficient part of the market.

A company's management is of paramount importance to us. At small companies, just a handful of top executives are largely responsible for the success of the entire enterprise. We make numerous management calls and HQ visits to verify that the people in charge are capable of seizing the opportunity at hand. A good product, without good management, is just a good product — not a good business. We invest in companies whose insiders own a significant portion of the shares; we want leaders whose net worths *and* self-worths are tied to the fortunes of the companies they run.

The kinds of companies we are describing hold the potential to generate extraordinary returns, but in order to earn those returns we must be able to remain anchored to a long-term view of the business despite a bad stretch of results. This requires patience, sometimes years of it. This is simply not a stance that most public investors can take.



We can. Our steadfastly long-term orientation is possible because we've structured Lightsail with precisely this concern in mind. The capital commitments that you, our partners, have made position us to look beyond short-term swings in fortune, and to invest with a view to what a young company will look like as it starts to mature.

The staying power to make long-term investments is not the only benefit Lightsail derives from your presence as Limited Partners. Your capital allows Lightsail to do more. With scale, we can support the businesses we own more meaningfully. We can make direct investments in companies that are raising capital, or buy large blocks of stock from legacy shareholders of a business in transition. Scale can help protect our interests as well, lending the weight of a more sizeable shareholding to our ongoing interactions with management teams and boards of directors. Internally, it means we can undertake operating investments (in people, technology, and other resources) that improve our collective odds of success.

Beyond this, one of the greatest benefits of having Limited Partners is simply having Limited Partners. You are a group of successful and intelligent people with experience across a diverse collection of industries and professions. Our partnership has already profited from your input about the new companies, products and technologies we are researching, and we know we will continue to do so.

You have made a commitment to us, and in turn we are making a few commitments to you.

The first is that **we share in the rewards of this endeavor fairly**. This begins with the fact that we are investing our own capital into Lightsail, and keeping it there – we've made the same multi-year commitment with our money that you have as Limited Partners. It continues with fair fees: our management fee, meant to cover our costs, scales down as assets grow; our performance fee, derived only from superior results over time, is subject to a hurdle and can only be withdrawn over three years.

The second commitment is to **transparency and communication**, which are vital to a healthy partnership. To that end, we will write to you quarterly, sharing the important events and decisions of the previous period. The first three quarters' letters each year will be concise updates on the portfolio, and then, at the close of each year, you can expect a longer letter explaining the portfolio and its prospects in detail. We will also frequently share in-depth research on individual companies with you (see the Capital Allocation section below for our first example), as well as any particularly instructive thoughts we have on general investing topics. We believe strongly in the quality of our work, and we want to share it with you to the greatest practical extent.

You may always reach out to us for much more detailed disclosures than the nature of these letters allow. *Please take advantage of this.* We welcome your e-mails and phone calls. We are excited to work for you and to have you as our partners.



Performance

We present Lightsail’s returns against two indices: the Russell 2000 Total Return Index of small US stocks, and the S&P 500 Total Return Index of the largest US stocks. The first is broadly representative of what we do (with significant caveats elaborated in the small print at the end of this letter), and the second is the most widely-followed, and hence relevant, index to investors. Because our capital will be placed in just ten or so securities, our returns are unlikely to show strong correlation to these – or any – market indices, but we feel these are the best indices representing long-term exposure to North American public equities.

We will compare our results to the Russell and S&P every quarter, but our investment process does not – and will never – include an effort to compete with the indices over any short period. Lightsail’s objective is to beat the benchmarks by a wide margin over three or more years. Short-term results are irrelevant in our minds. A long-term focus is the core of what we do.

	Lightsail Partners LP (net)	Russell 2000 Total Return Index	S&P 500 Total Return Index
2Q 2018 (from April 16th inception)	5.9%	6.3%	2.8%

Please refer to the disclosures at the end of this letter.

During our slightly abbreviated opening quarter, we returned 5.9% net of fees, with 46% of our capital invested at the end of the period. This return compared to 6.3% for the Russell 2000 and 2.8% for the S&P 500. Since we had less than half of our capital invested, the securities we *did* own outperformed the Russell 2000 by more than double. In some cases the strong performance of our holdings was due to positive corporate developments, and in some cases it was driven by the rising market. In general we do not view performance over such a brief period as meaningful, but we’re certainly pleased with our start, while also feeling that our portfolio is still significantly undervalued.

For this inaugural quarter, we waived the management fee for all Limited Partners, which positively affected performance slightly. Many investors hesitate to join a fund on day one. Thank you for being with us at the beginning.

Capital Allocation

As we mentioned above, as of June 30th we had invested 46% of Lightsail’s capital in securities, with the rest held in cash. Our largest position was 10% of our assets, and our five largest positions in aggregate were 37%.

One of our large holdings is DIRTT Environmental Solutions, a Canadian company bringing dramatically better technology to the world of nonresidential interior construction (the name is an acronym for “Doing It Right This Time”). DIRTT has created an entire building system comprising



design software, automated manufacturing, and a superb portfolio of prefabricated modular interior components. DIRTT is the kind of company we want to own. It is in the early days of selling an innovative product into a large, unpenetrated market, but its shares are priced very attractively due to difficulties we deem temporary. In DIRTT's case, those difficulties relate to leadership changes at both the board and management levels which, while disruptive in the short term, present the opportunity for significant positive change in the long term.

DIRTT stock trades in Canada, where many of the institutional investors are focused on financial and natural resource businesses, and often neglectful of companies in other industries. If DIRTT lists in the United States – something which we think will happen within the next few years – we would not be surprised to see the company's market value increase dramatically simply as a result of improved access to growth capital in the U.S. DIRTT is a unique company with a promising future. In May we wrote a detailed memo describing the business and the reasons for our investment, which is available [here](#) (password: Kepler).

Our other holdings include a patent-protected surgical device company, a broadband provider, two enterprise software companies, and a regional bank with a unique lending model. Most of these businesses sell products that are necessary rather than discretionary, and during a recession we would expect them to suffer very little reduction of demand. Their share prices may be volatile owing to their illiquidity, but the need for their products will remain consistent. As a rule, you can expect that the majority of the Lightsail portfolio will be invested in stable, recession-resistant businesses. Our goal is to compound our capital. In order to compound, we must first survive. This sounds grim, but we believe that vigilantly minimizing downside is one of the cornerstones of superior long-term investment performance. In our case, we minimize it by paying low prices, for companies we know intimately, that sell products customers need.

Most of our efforts now are focused on investing the remaining capital. We would have liked to invest more of our capital by the end of the quarter, but the very strong performance of small stocks drove some of our prospects above prices we were willing to pay. We also sold a large position during the quarter, whose name we won't disclose for now, as we hope to get another bite at the apple in the future. This investment was a holdover from Monte Sol's portfolio, and had increased 70% in the three months prior to our exit. We wanted to continue owning these shares for many years, but we could not envision an attractive IRR from the price where we sold, even in our most optimistic scenarios. Over the course of Lightsail's existence, we expect to have very few positions with such short holding periods. We hope market fluctuations will give us another opportunity to purchase this company's stock at an attractive price, and we look forward to reporting to you on it more fully then.



Looking Forward

We formed Lightsail together, rather than continuing in our separate endeavors at Blacktree and Monte Sol, because we are convinced — after more than five years of extensive collaboration — that working in partnership will increase the scope of what we can achieve in the years to come. It is our great fortune to have found the best kind of partner in one another: a capable, ethical, and committed teammate with the same philosophy and vision. We have each invested the majority of our liquid net worths into Lightsail, and with our families we are (for now) its largest investors.

Investing is a long game. Our ambition is to be able to measure our partner relationships in decades. To survive for so long a time, we must place one priority above all others: avoid major mistakes. But to *thrive*, we must also have an intrinsic optimism that encourages our involvement in markets regardless of the economic tides. Too timid, and we are merely caretakers; too aggressive, and we are merely gamblers. To us, striking a balance between thoughtful caution and intrinsic optimism defines what it means to be stewards of your capital.

The ship is built, the sails are up (lightsails, of course), and we have embarked on what we think will be a long and successful voyage. We are grateful for the trust and support that come along with your capital.

Sincerely,

James Basili & Torin Eastburn
Managing Partners



Disclaimer

Lightsail Capital Management LLC (the “Investment Manager”) is a private fund advisor exempt from registration. The Investment Manager provides discretionary investment advisory services to Lightsail Capital Partners LLC (the “General Partner”) and, through the General Partner, to Lightsail Partners LP (the “Partnership”). Lightsail Capital Management LLC and its affiliated entities (“Lightsail”) are providing this document on a confidential basis, and for informational purposes only. Any reproduction or other distribution of this material in whole or in part without the prior written consent of the Investment Manager is prohibited.

This document shall not constitute an offer to sell or the solicitation of any offer to buy any security or investment product. Any such offer or solicitation to invest in the Partnership may only be made by means of delivery of definitive offering documentation, which contains important information (including investment objective, policies, risk factors, fees, tax implications and relevant qualifications), and only in those jurisdictions where permitted by law. In the case of any inconsistency between the descriptions or terms in this document and the definitive offering documentation, the offering documentation shall control. These securities shall not be offered or sold in any jurisdiction in which such offer, solicitation or sale would be unlawful until the requirements of the laws of such jurisdiction have been satisfied. Due to, among other things, the volatile nature of the markets, and an investment in the Partnership may only be suitable for certain investors. Parties should independently investigate any investment strategy or manager, and should consult with qualified investment, legal and tax professionals before making any investment.

An investment in the Partnership 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 can be no assurance that the Partnership’s investment objectives will be achieved, or that it will or is likely to achieve results comparable to those shown herein, or will make any profit, or will be able to avoid incurring losses. Past results are no guarantee of future results. All investments involve risk, including but not limited to the loss of principal. Investors must be prepared to bear the risk of a loss of their investment.

The description of investment strategies in this document is intended to be a summary and should not be considered an exhaustive and complete description of the potential investment strategies used by Lightsail. Specific companies or securities shown in this document are meant to demonstrate Lightsail’s investment style and the types of situations and instruments in which we invest and are not selected based on past performance. Positions reflected do not represent all the positions held, purchased, or sold by the Partnership, and in the aggregate, the information may represent a small percentage of activity. There is no assurance that the Partnership will make any investments with the same or similar characteristics as any investments presented. The investments are presented for discussion purposes only and are not a reliable indicator of the performance or investment profile of the Partnership.

While Lightsail has used its best efforts in preparing this document, and believes all the information herein to be accurate and from reliable sources, it makes no representation or warranty with respect to its completeness or accuracy, nor can Lightsail accept responsibility for errors appearing in the document related to information obtained from third parties. Any projections, forecasts, or estimates in this document are necessarily speculative in nature and are based upon internal analysis and certain assumptions which reflect the views of Lightsail as of the date indicated, and should not be construed to be indicative of actual events that will occur. No representations or warranties are made as to the accuracy of such forward-looking statements. Any statements of opinion constitute only current opinions of Lightsail, which are subject to change and which Lightsail does not undertake to update.

Disclosure

The performance information herein has been prepared by or on behalf of Lightsail and has not been independently audited. All performance results for the Partnership are calculated based on the aggregate net asset value of fee paying investors only, and are presented net of management fees charged, brokerage commissions, administrative expenses, and accrued performance allocation, if any, and include the reinvestment of all dividends, interest, and capital gains. While performance allocations, if any, are accrued monthly, they are deducted from investor balances only annually or upon withdrawal. The performance results represent fund-level returns, and are not an estimate of any specific investor’s actual performance, which may be materially different from such performance depending on various factors, including the timing of contributions and withdrawals and any special terms granted to an investor. All performance results are estimates and are subject to future adjustment and revision. Investors are encouraged to review their capital account statements to obtain their individual returns.

While the performance of the Partnership has been compared here with the performance of well-known and widely recognized indices, any index or benchmark comparisons herein are provided for informational purposes only and should not be used as the basis for making an investment decision. There are significant differences between Lightsail’s strategy and the benchmarks referenced, including, but not limited to, risk profile, liquidity, volatility and asset composition. The index performance results shown include the reinvestment of dividends.