Q2 2018 Alta Fox Opportunities Fund, L.P. Quarterly Letter July 2018

Limited Partners,

In Q2 2018, the fund was up 7.82% gross and 6.05% net compared to 3.43% for the S&P 500. The average gross exposure during the quarter was 98.3%. The average net exposure during the quarter was 88.7%. We had strong performance attribution from both micro-caps ($<300M USD market cap) and large-caps ($10B+ USD market cap). See the appendix for further performance details.

While I am pleased that the fund is off to a solid start, I also view such short-term results as mostly "noise" amid our larger investment objectives. To overly praise or bemoan one quarter's results would distract from the long-term focus of the fund. I am much more focused on the intrinsic value growth in our portfolio holdings, which over the long-run, should converge with portfolio performance.

Going forward, I will use the quarterly letters to comment on any big moves in the portfolio, discuss my investing approach in the current markets, and occasionally discuss one or more ideas. We will also periodically post ideas to altafoxcapital.com (such as our long HTL idea) and other sites, but only if we are not actively trading the name and believe we can substantively add to the market discussion. In general, I hope to keep the quarterly letters brief and expand more in the year end letter, but since this is the first quarterly letter of the fund, I will take this as an opportunity to share my vision for the long-term goals of the fund, provide my current view of the market, and introduce two holdings (including one with further analysis on our website).

Introduction and Long-Term Goals of the Partnership

I am humbled to manage a portion of your investing capital. I have a majority of my net worth invested in the fund right alongside you and look forward to the years ahead. I view the fund as a long-term investment with the goal of outperforming the S&P 500 over full market cycles. I am sometimes asked why I use the S&P 500 as a benchmark. The short answer is I do not know of a better alternative. There is not an index that comes close to replicating the style of investments our portfolio represents (mix of micro-cap, small-caps, special situations, and best in breed large-caps). Without a good proxy, I have decided to use the S&P 500 because one can invest in it with great ease and tax efficiency. Moreover, it has proven to be a difficult benchmark for most managers to outperform over time.

There are many decisions involved in starting a hedge fund, and I have taken every step possible to position the fund for long-term success. This includes spending significant capital upfront to have the right legal team, compliance protocols, infrastructure, data partners, and other vendors. It includes implementing strict risk controls as checks on my own research process and sizing decisions. Finally, it means challenging the portfolio and operational process status quo every day to get better. I am confident I have made the right long-term decisions for the fund and expect this will be a competitive differentiator versus small and micro-cap focused peers over time.

In the last decade, large hedge funds have increased their share of industry assets at the expense of smaller funds, the average stock holding period has shortened, and index funds have become a much more significant percentage of daily volume. A significant motivating factor that led me to

create Alta Fox was my belief that these trends have created a significant opportunity for investors willing to go against the grain. Specifically, the opportunity is to conduct high quality fundamental research on primarily small and micro-cap equities with a long-term time horizon. I define long-term success for the fund as outperforming the market over full market cycles through conducting world-class research and a repeatable fundamental investment process. That is what I am striving for each day and I appreciate your support.

Research process

How do we hope to outperform? The short answer is: the market tends to be short-term oriented which results in a general valuation method used by the market that while often reasonable, can result in substantial mispricings for a certain subset of investment categories. Specifically, ~90% of valuations are the result of forecasting financials for one to two years out and applying an earnings or EBITDA multiple based on comparable companies. This valuation method tends to be reasonable for companies with little change, are widely followed for a long period of time, and have many highly similar companies to benchmark against. However, this valuation method by "Mr. Market" is often not as effective when analyzing companies undergoing significant and rapid change, new companies the market has not had a long time to analyze, companies without any good publicly traded comparables, companies that are poorly followed without good (or any) consensus estimates, highly cyclical companies with multi-year cycles, and finally, companies with unusually long and profitable growth runways due to significant and enduring competitive advantages.

We specifically target these investment categories where traditional valuation shortcuts fail to properly assess intrinsic value and we take a long-term view on high-quality businesses. This often leads us to small and micro-cap equities where we can more frequently obtain an informational and analytical advantage. For a longer and more complete overview of my investing philosophy, I encourage you to listen to a recent podcast interview (about 1 hour in total) I did on Planet Microcap Podcast: https://www.altafoxcapital.com/about/.

Current View of Markets

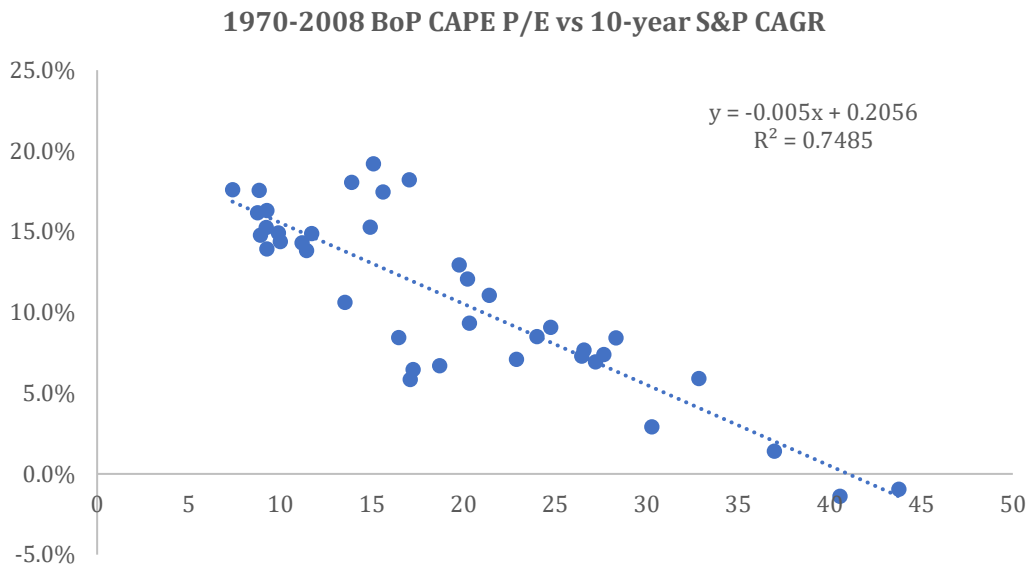
"If you spend more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes." – Peter Lynch

I tend to agree with Peter Lynch on the above quote and do not spend much of my time worrying or forecasting macroeconomic factors for which I cannot claim any real edge. However, I believe it is important to have a "30,000-foot view" of where the markets are in the economic cycle, which should inform portfolio-level aggressiveness or conservatism. It is particularly useful at market extremes. The below analysis should be considered my allotted "13 minutes" for the year.

One metric that can provide a high-level view of the market's valuation is the Shiller PE ratio, which is a price/earnings ratio for the S&P 500 based on the current price of the index divided by the average inflation-adjusted earnings from the previous 10 years. While there are many flaws with this approach, I am unaware of any fundamental metric that has a better long-term correlation with returns.

The below plot shows the beginning of year CAPE P/E Ratio (X axis) versus the next ten years S&P 500 compound annual growth rate (Y axis). For example, the far most left dot in the graph below

represents a CAPE PE of 7.39. This was the CAPE PE ratio in January 1982, the cheapest since 1970. The 10-year CAGR for the S&P 500 from that point in time is represented by the Y axis, which in this case was 17.6%. There has historically been a fairly strong correlation (.74 R^2) between beginning of period CAPE PE ratio and resulting 10-year S&P 500 CAGR[1].



However, the same analysis run for only a five-year period results in a very weak R^2 of 0.33. When you reduce the timeframe to just one year, the plot is useless (R^2 is just 0.05). My takeaways are as follows:

1) In the long-run, valuations do matter and tend to be cyclical.

2) In the short-term, these metrics tell you nothing about where the market is going.

3) With a current CAPE PE Ratio > 33.0x, valuations are closer to peak than trough levels. Using the historical 10-year regression model, this would suggest that the 10-year CAGR for the S&P 500 from current levels will be around ~4.0%, well below historical averages.

Of course, this is just a long-winded way of saying that the market as a whole appears somewhat expensive. It is possible that this forecast will prove wildly wrong, but it does serve as a helpful reminder of valuation cyclicality. It is easy to get complacent after a decade long bull market.

[1] Source: Bloomberg, Multpl.com, Alta Fox analysis.

Historical CAPE PE Ratio[2]:

How Alta Fox is Positioned Today

1) We have low gross exposure (~90%) providing "fresh powder" as we identify compelling opportunities on both the long and the short side.
2) We have normal (for us) net exposure: in the ~80% range.
3) The majority of capital is in idiosyncratic small-cap investments whose success is less dependent on the macro-environment than the average stock in the S&P 500.
4) Most importantly, our longs are (in our opinion), conservatively positioned. We have been very tactical in the business models and industries in which we have invested given our overall cautious view of where we are in the economic cycle.

Again, while the "30,000-foot view" is helpful to think about once a year or so, it does not dominate the day-to-day research process. I have no view on how the market performs over the next year, which in my opinion, is the prudent view. I remain focused on buying high-quality businesses that can outperform in any macroeconomic environment and shorting businesses which have underappreciated secular pressures.

At the time of writing, the fund owned 16 long positions and two short positions. The top five positions in the fund represented 55% of capital invested.

[2] Source: Bloomberg, Multpl.com, Alta Fox Analysis.

Two Current Portfolio Companies

1) Long: 3Pea International, Inc. ("TPNL")

3Pea International ("TPNL") is a high-quality payment provider to the domestic plasma industry with excellent returns on capital, a long growth runway with high incremental margins, an attractive duopoly industry structure, and multiple near-term catalysts. Insiders own ~50% of the company, including the founder/CEO, Marc Newcomer, who owns ~21% of the company and has not sold a single share despite a 10x+ increase in share price since 2016. Moreover, Dan Henry, a widely respected pioneer in the payments space, agreed in May of this year to join the company as Chairman of the Board. I believe TPNL's existing plasma payments business is conservatively worth over $5.00/share (~100% upside). Moreover, the company has three other initiatives that I believe have a reasonable chance of pushing fair value above $10 over the next 3 years (~300% upside).

To see our full TPNL analysis, visit: https://www.altafoxcapital.com/research/.

2) Long: Xpel Technologies Corp. (DAP/U)

XPEL Technologies Corp. provides primarily paint protection film ("PPF") for cars. PPF is a thin, clear layer of film that is installed to protect cars from scratches, dirt, chips, etc. The company has had explosive growth over the last several years growing revenue (mostly organically) almost 60%/year from 2011-2015 while averaging a ~13% EBITDA margin. Revenue growth slowed in 2016 and 2017 to a still healthy 24.8% and 30.9% respectively, but EBITDA margin fell to 8.5% in 2016 and an all-time low of 5.9% in 2017. I believe that the company's EBITDA margin compression was an anomaly caused by a now settled lawsuit with competitor 3M and temporary supply issues with Xpel's manufacturing partner.

The company's Q1-18 results provided strong evidence for this view as Xpel grew revenues 99.5% y/y with a 12.0% EBITDA margin and company management suggested that nothing about the top-line or margin performance was transitory. I think Xpel will grow revenue ~65% this year and it trades for only ~11x my base case EPS estimate for 2018 and ~1x revenue. It is very rare to have the opportunity to buy into a high quality, fast-growing, asset-light business with an incentivized management team in an oligopolistic market at such low multiples. I believe Xpel will handily outperform the market over the next several years through the combination of a rapidly-growing top-line, margin expansion, and an increased multiple of earnings.

Closing Points

I am humbled that you have elected to invest a portion of your assets with me and am excited about the prospects of our portfolio companies. The fund had a successful July 1st capital raise that exceeded expectations. Our next capital opening will be September 1st.

Current investors can access returns and current capital balances at this link.

If you are not a current L.P., but are interested in more information about the fund, please email: info@altafoxcapital.com. We welcome referrals for long-term oriented investors interested in idiosyncratic small/ micro-cap exposure. Investors can sign up for our email distribution list for all future updates and publicly posted ideas here: https://www.altafoxcapital.com/contact/.

"Have the courage of your knowledge and experience. If you have formed a conclusion from the facts and if you know your judgement is sound, act on it—even though others may hesitate or differ. You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right." — Benjamin Graham, The Intelligent Investor

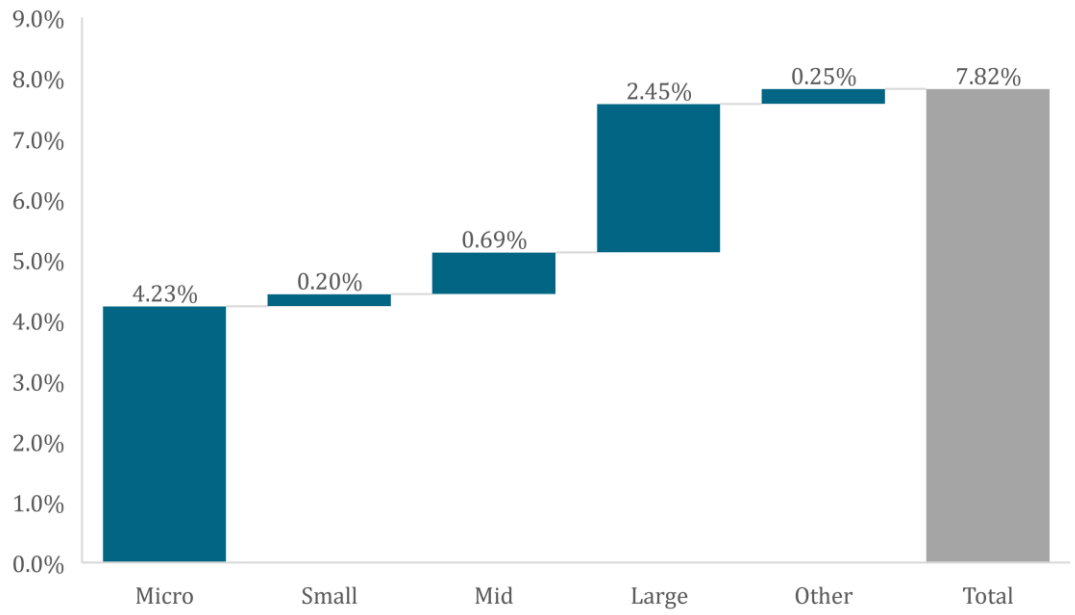
Sincerely,

Connor Haley

Appendix: Historical Returns

	Alta Fox Gross	Alta Fox Net	S&P 500 Index
Apr-18	2.63%	2.03%	0.38%
May-18	3.56%	2.80%	2.41%
Jun-18	1.45%	1.11%	0.62%

Q2 2018 Gross Attribution by Market Cap



For the attribution above, the beginning of quarter market cap ranges (taken at time of investment) are defined, in U.S. dollars, as:

Micro: <$300M
Small: $300-$1,000M
Mid: $1,000M- $10,000M
Large: $10,000M+

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