
Q4 2018 Alta Fox Opportunities Fund, L.P. Quarterly Letter

January 2019

Limited Partners,

In Q4 2018, the fund declined 11.52% on a net basis compared to declines of 13.52% and 20.20% for the S&P 500 and Russell 2000, respectively. The average net exposure during the quarter was 77.23%. For the year (April inception to date), the fund was up 6.67% net compared to declines of 3.65% and 10.94% for the S&P 500 and Russell 2000, respectively. The average net exposure for the year was 80.36%.

Our fund is a long-biased and small/micro-cap focused vehicle. 2018 was not a favorable environment for this strategy as the Russell Microcap index lagged the Russell 2000 which lagged the S&P 500. In the context of a market in which 90% of asset classes declined¹ and our strategy was out of favor, I consider the fund's 6.67% net return a good result. A factor analysis of our results (available to current LP's by request) confirms that our small-cap bias along with currency impact were meaningful headwinds to performance in 2018, while our "selection effect" was significantly positive, enabling the fund to generate a positive return in an unfavorable environment.

Most importantly, however, I believe the recent absolute and relative weakness of small and micro-caps has likely created a favorable environment for our strategy moving forward. My watchlist has never been longer and I have taken advantage of recent weakness to upgrade our portfolio from both a business quality and valuation perspective. As always, I largely ignore short-term results to instead focus on the intrinsic value growth in our portfolio holdings, which over the long-run should converge with portfolio performance.

Current Market Environment and Recent Portfolio Changes

Despite the market's recent rally, investors enter 2019 with a looming fear of "late-cycle" risk. Comments from Howard Marks in a mid-2018 interview effectively summarize this view:

*"You know, ever since the global crisis, which means ten years, people have been asking me what inning are we in. And now I would say we're in the 8th inning... However, we have to notice that this isn't baseball, and we don't know how many innings there will be... But, you know, when you're talking about being in the 10th year or 11th year of recovery and the 10th year of a bull market, how much do you want to push your chips out on the table? Or do you want to take a few off? That's really the key question."*²

Even though the S&P 500 became significantly cheaper during Q4 on traditional forward valuation metrics, it also ignited fear in market participants that the economic cycle was about to turn and that forward estimates are far too high. Combine this late-cycle fear with a fixation on the Fed's policy towards interest rates and Trump's latest trade tweets, and Q4 was a wild quarter by any measure.

¹ https://www.wsj.com/articles/no-refuge-for-investors-as-2018-rout-sends-stocks-bonds-oil-lower-1543155033?mod=hp_lead_pos5

² <https://www.valuewalk.com/2018/07/oaktrees-howard-marks-stock-pricing/>

As usual, I try to filter out the market noise as much as possible in order to focus on my bottom-up research process. Of course, economic cycles and trade deals are important fundamental data points, but I do not pretend to have any advantage in predicting these events. Therefore, my primary focus is to identify companies that I believe can outperform in any market environment. In practice, this mostly market-agnostic approach means I generally avoid purchasing commodity-based stocks, deep cyclical companies, etc. in favor of companies with more idiosyncratic fundamental theses. While identifying these secular winners is easier said than done, I feel confident about how the portfolio is positioned for 2019.

Portfolio Commentary

3Pea International, Inc. (“TPNL”) is still our top holding and is a good example of the type of secular winner we attempt to identify. I believe it is an extremely high quality and recession-proof business that can compound value at very high rates for the next several years. It was a significant contributor to fund performance in 2018, and I have high expectations for 2019.

There are two other long positions that are new top five holdings. However, given I am still trading them actively, I will wait to disclose the names until the Q1 letter is released. Both are leaders in their respective industries, have excellent management teams, and have a long growth runway to compound shareholder value at attractive rates. In addition, the company recently entered into a long position in RumbleOn, Inc. (“RMBL”). While this is not a typical Alta Fox long position, I think the risk/reward is compelling enough to warrant a small and somewhat speculative long position. You can view the original TPNL idea and RMBL deck here:

<https://www.altafoxcapital.com/research/>.

The fund recently sold all of its shares in Hamilton Thorne (“HTL”). Given this is the first sale of a company that I have previously profiled at length (in letters and on the Alta Fox website), it feels appropriate to highlight the reasons for the sale.

1) While HTL’s revenue growth has been in-line with my expectations, the company’s gross margins and operating margins have been a disappointment. Gross margins have continually declined as a result of distributing more third-party products. Meanwhile, the company has not provided any evidence they can leverage their existing SG&A costs. As a result, EBITDA has been flattish for the last six quarters despite strong revenue growth. I think the company is in the unenviable position of having to choose between accelerating revenue growth or showing EBITDA improvement. At the time I made the investment, I believed the company could translate strong revenue growth into equally or even stronger EBITDA growth. This has not materialized.

2) HTL has not made a major acquisition in a while. The company is constantly touting how many conversations they are having with potential acquisition targets and the company recently did a dilutive secondary offering in order to raise funds for potential deals. However, the company’s most recent acquisition was in July for a business doing less than \$500K in annual revenue. While I am sure the deal will be accretive, it does not move the needle. It concerns me that the company was even spending time on such a small target. My impression is that most of the larger potential acquisitions are not available at attractive prices, which is a significant impediment to the roll-up thesis.

3) The stock was approaching my original fair value target while the fundamentals had become less exciting, so we exited the position with an attractive IRR. We will continue to follow the business closely, but are on the sidelines for now as I have found more exciting places to allocate capital.

Other Updates

As mentioned in the last quarterly letter, I sponsored a collegiate stock competition at Harvard in October. There were over 30 high-quality entries. 10 finalists were picked to present at Harvard in front of a panel of judges including myself. The winning pitch was [SNFCA](#) by a team from Wharton, 2nd place was [CRHM](#) by a team from Georgetown, and third place was [PMD](#) by a team from Northeastern.

Conclusion

2018 was an up and down year, but overall a successful launch for Alta Fox. We significantly outperformed the major indices in a year when our style was out of favor. We grew the number and size of LP's meaningfully. Most importantly, I think we have a great foundation of long-term focused LP's and an investment strategy that can produce attractive absolute and relative returns over a full economic cycle.

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. Our next capital opening will be March 1st.

Current investors can access returns and current capital balances at [this link](#).

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

"You don't have to be brilliant, only a little bit wiser than the other guys, on average, for a long, long time."

— Charlie Munger

Sincerely,



Connor Haley

Appendix

Monthly and Quarterly Fund Returns

	Alta Fox Gross	Alta Fox Net	Alta Fox Net Exposure
Apr-18	2.63%	2.03%	48.91%
May-18	3.56%	2.80%	95.06%
Jun-18	1.45%	1.11%	91.32%
Q2-2018	7.82%	6.05%	78.43%
Jul-18	7.36%	5.91%	80.92%
Aug-18	9.53%	7.77%	81.12%
Sep-18	-0.41%	-0.40%	94.28%
Q3-2018	17.12%	13.68%	85.44%
Oct-18	-10.16%	-8.55%	83.02%
Nov-18	-0.22%	-0.25%	71.47%
Dec-18	-3.59%	-3.01%	77.20%
Q4-2018	-13.57%	-11.52%	77.23%
YTD	9.13%	6.67%	80.36%

S&P 500	Russell 2000	Russell Microcap
0.38%	0.86%	1.25%
2.41%	6.07%	7.22%
0.62%	0.72%	1.30%
3.43%	7.75%	9.97%
3.72%	1.74%	-0.07%
3.26%	4.31%	4.30%
0.57%	-2.41%	-3.26%
7.71%	3.58%	0.83%
-6.84%	-10.86%	-10.90%
2.04%	1.59%	-0.64%
-9.03%	-11.88%	-12.05%
-13.52%	-20.20%	-22.14%
-3.65%	-10.94%	-13.67%

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