ALTA FOX CAPITAL

Q3 2019 Alta Fox Opportunities Fund, L.P. Quarterly Letter October 2019

Limited Partners,

In Q3 2019, the fund decreased 2.21% gross and 2.10% net. This compared favorably to the -2.40% return for the Russell 2000 and -5.4% return for the Russell Microcap index, but unfavorably to the S&P 500's 1.70% return. The average net exposure during the quarter was 79.01%. Year to date, the fund has returned 48.81% gross and 38.24% net compared to 20.55% for the S&P 500, 17.58% for the Russell 2000, and 12.59% for the Russell Microcap index. Since inception in April 2018, the fund has returned 62.40% gross and 47.45% net compared to 16.15% for the S&P 500, -0.39% for the Russell 2000, and -8.91% for the Russell Microcap Index. See the appendix for further details.

As always, I strive to ignore short-term fluctuations and instead focus on the intrinsic value growth in our portfolio holdings, which over the long-run should converge with portfolio performance. I encourage limited partners to do the same (both in times of outperformance and underperformance). I firmly believe that in the long-run, our strategy of buying high-quality and underfollowed businesses at cheap prices will deliver attractive absolute and relative returns. Most importantly, our process will remain disciplined with strict risk controls, minimal to zero gross leverage, and a sound research process.

"Zooming in and Out"

The concept of "zooming in and out" is an important one for my investment process, both from a single idea and a portfolio construction perspective.

For any individual idea, it is important to "zoom in" to understand the unit economics of a business, appreciate the finer nuances of the financial model, and to develop a sound valuation technique. However, it is equally important to "zoom out" and to understand at a higher-level what could go wrong, develop intuition for risk and uncertainties that transcend a few valuation scenarios, and know when to ride winners or when to fold losers. For a broader portfolio management perspective, it is also important to zoom in and out. It is important to track performance relative to indices over time as that is ultimately the measuring stick, and if the market is disagreeing with you, it is important to know why. However, one has to zoom out and focus on the process because too much focus on short-term performance is absolutely detrimental to day by day decision-making.

The abilities to zoom in and out are different skills. This is one of the primary distinctions between a good analyst and a good portfolio manager. They have complementary, but different, skill-sets. An analyst is most often tasked with "zooming in," which normally involves ripping a business apart and understanding the filings at a very rigorous level. A portfolio manager, on the other hand, must have an overarching philosophy on how to allocate scarce research time to specific ideas, passing on others, how to size positions, etc. The best investors are capable of simultaneously zooming in and out.

The fact that successful fundamental investing requires often opposite skill-sets and impulses is alluded to in one of my all-time favorite investing quotes from Seth Klarman:

> "Complicating matters further, a successful investor must possess a number of seemingly contradictory qualities. These include the arrogance to act, and act decisively, and the humility to know that you could be wrong. The acuity, flexibility, and willingness to change

your mind when you realize you are wrong, and the stubbornness to refuse to do so when you remain justifiably confident in your thesis. The conviction to concentrate your portfolio in your very best ideas, and the common sense to nevertheless diversify your holdings. A healthy skepticism, but not blind contrarianism. A deep respect for the lessons of history balanced by the knowledge that things regularly happen that have never before occurred. And, finally, the integrity to admit mistakes, the fortitude to risk making more of them, and the intellectual honesty not to confuse luck with skill." – Seth Klarman

I mention the "zoom in and out" concept in this quarterly letter because it was on my mind quite a bit in the third quarter. We are at all-time highs in the S&P 500. I have been itching to put on large and aggressive positions, but the reality is I have passed on many ideas lately because they have not quite met my return thresholds. As a result, the portfolio has been fairly defensively positioned with a small-cap bias, and that was out of favor in the third quarter. Zooming out, however, I am unconcerned. I think the opportunity set is still very attractive on a global basis. More of my research time recently has been spent on international opportunities, which tends to be a longer research process for me than domestic names. While I never have a view on short-term quarterly results, I think Alta Fox is making the right portfolio and business decisions to position the fund for success over the next three years. I expect to expand on this theme in the end of year letter.

Recent Portfolio Results

Koru Medical (KRMD)—recently changed its ticker and company name from Repro-Med (REPR)

KRMD was the biggest winner in the portfolio in Q3. It is a medical device company that has a razor/razorblade model that enables patients with primary immunodeficiency disease ("PIDD") to self-administer plasma-derived treatments through subcutaneous infusion. There are roughly 270,000 people with PIDD in the U.S., but only ~70,000 (36%) are currently being treated. The primary reason for this large gap is that PIDD is difficult to diagnose, but awareness has been increasing. As a result, while the population with the disease is growing ~2% per year, the percentage of patients treated is growing closer to 10% per year. However, the story gets better for KRMD. Of the 70,000 patients currently being treated for PIDD, nearly 2/3 of those patients are being treated through intravenous therapy typically with one large dose per month in either a hospital or specialty clinic. This is suboptimal in several ways: it is inconvenient for the customer who has to go to the clinic and then receive a large dose through an IV, it is a high dose of a drug administered all at once (many patients feel sick afterwards and the effectiveness of the drug drops off significantly after a few weeks), and finally, it is very expensive for the healthcare industry since a dedicated facility and nurse are required.

This is where KRMD's solution enters the picture. KRMD's subcutaneous infusion pump allows the patient to self-administer therapy at home, typically in smaller doses about once per week. The company currently has ~80% market share of the PIDD subcutaneous market--- a market that is growing double digits and offers stable, recurring revenue. I know the drivers of this market fairly well given my previous work on PaySign Inc (PAYS). KRMD is in a different part of the plasma supply chain than PAYS, but nonetheless benefits from double digit secular growth in patient count. I believe the company is undervalued based on their current PIDD and CIPD indications due to 20%+ sustainable revenue growth, 70% gross margins, and significant operating leverage. Moreover, there is a chance that the current management team and board, which is impressive for a micro-cap, can create value by extending the use of their pumps for other emerging subcutaneous drugs. If I am right, the stock could have multiples of upside from current levels.

Keywords Studios PLC (KWS)

KWS was the biggest loser in the portfolio in Q3. I will spare the full thesis rehash since I discussed it in the last letter, but the stock declined because of Q3 results, which were deemed disappointing by the market. The company grew revenue 17% organically, but margins declined as the company had to invest heavily in temporary space, pay overtime for employees, and boost recruiting efforts to keep pace with demand. The disappointing margins increased conviction for bears who believe that this company is no more than an outsourced labor company.

I too was surprised by the magnitude of the margin decline, but believe the share price has overreacted. While the company does have elements of an outsourced IT player, they also have very valuable relationships with 23 of the top 25 gaming companies in the world and serve an important and growing function for them. KWS also has a history of value creation by rolling up smaller independent studios that benefit from KWS' centralized sales and support functions. We remain long as I think the company is well positioned for secular video game growth, has a long history of creating value through both organic and inorganic growth, and is selling close to a 3-year trough multiple on forward earnings.

One Group Hospitality Inc. (STKS)

This restaurant owner and operator of the "STK" steakhouse chain had a busy third quarter and is worth revisiting. The company made a transformational acquisition by acquiring 24 "Kona Grill" stores out of bankruptcy for $36M in total consideration. This was a surprise, and I did significant diligence on the Kona acquisition to become comfortable with the changing investment thesis.

Kona Grill is an interesting case study. In 2015, the market cap of Kona was greater than $300 million. The previous management team managed to take a healthy chain of 23 stores in 2012 that generated over $11M in reported EBITDA and $18M in 4-wall EBITDA (pre-corporate expenses) with growing same store sales to bankruptcy just seven years later. This was a classic case of overexpansion. Kona's previous management team increased the store count from 23 stores in 2012 to 46 by 2017. They spent over $129 million in capex during that time period (wow!) and margins were crushed as the company tried to appease the equity market by showing high unit growth—even though it meant the company was expanding into locations that had exorbitant rent costs and were not realistic venues for the brand.

STK swooped in and bought the best 24 stores out of bankruptcy for a total consideration of $36M. Considering these stores cost over $3M/store to build and most have been renovated in the last several years, STK is buying at a substantial discount to asset value. Of course, this is irrelevant if the company cannot generate a decent return on that invested capital—but they are. In fact, even before the company went under and shuttered their money-losing stores, Kona generated $17.9M in restaurant operating profit in 2018 (11.4% restaurant operating margin), had $11.4M in G&A, and generated reported EBITDA of $6.5M. The 2018 economics were with double the number of stores Kona is purchasing, most of which were significant money-losers. The remaining 24 stores generate ~$100M in annual revenue at a mid-teens restaurant operating margin—implying around $15M of restaurant operating profit. The relevant questions are how much G&A will be required to support the brand and what is the trajectory for average unit volumes? In 2012-2013, when Kona had the same size store base (2/3 of which I estimate are part of the 24 STK is acquiring), the corporate G&A required to support the stores was $7-$8M. However, this number included a separate management team, as one ex-employee described "the Taj Mahal" of corporate offices, and a separate marketing and training team. STK will have significant G&A synergies and should be able to cut annual G&A expenses to the ~$5M range. This would imply ~$10M of Kona EBITDA. Combined with the expected contribution from the core STK brand of ~$15M in EBITDA next year, the business should do ~$25M of Adjusted EBITDA next year, consistent with management's new guidance. Applying a high-single digit EBITDA multiple can result in nearly a doubling from the current price without any improvement in Kona unit volumes.

However, I think the reason to be excited about this opportunity is that the Kona Brand is far from broken, there is low hanging fruit for STK to significantly improve average unit volumes at high incremental margins, and the CEO of STK has a proven playbook for executing this turnaround. Manny Hilario took over as CEO of STKS in Q4 of 2017. Almost immediately, he took same store sales for the brand from flat/negative to up high single digits for the past seven quarters. He did this while cutting SG&A in absolute dollar terms. The most important aspects of his playbook have been: a) to invest to improve the food quality and focus maniacally on the guest experience b) to increase corporate events and parties, and c) to develop a robust digital marketing effort. I expect Manny to execute a similar playbook at Kona Grill. I talked to many ex-Kona employees, from high level executives to store managers. A surprisingly clear narrative emerged from this diligence that suggested there was nothing wrong with the brand of Kona Grill and that under the right management, unit volumes could return to previous peak levels. If Hilario can execute a similar turnaround at Kona as he did with STK, the upside is much more than a double from current prices. Of course, this investment is not without risk. Restaurant turnarounds are hard, the company is levered, and operational leverage works both ways. However, I think the risk/reward is in our favor, it is appropriately sized in the portfolio given the level of risk, and I am excited to see what the STK management team can do with the Kona Grill brand.

Conclusion

I am proud of the process and results of the fund thus far. While the fund has grown faster than expected since launch, we are still well below any capacity constraints for our strategy. Importantly, the majority of our incremental investors have come from inbound inquiries, allowing me to focus nearly all of my attention on the portfolio rather than traveling and actively marketing the fund.

Our next capital opening will be December 1st. 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/.

Finally, I was recently a featured guest on the "Acquirer's Podcast," where I discussed my investment approach with Tobias Carlisle. If interested, the link can be found here.

Sincerely,

Connor Haley

Appendix

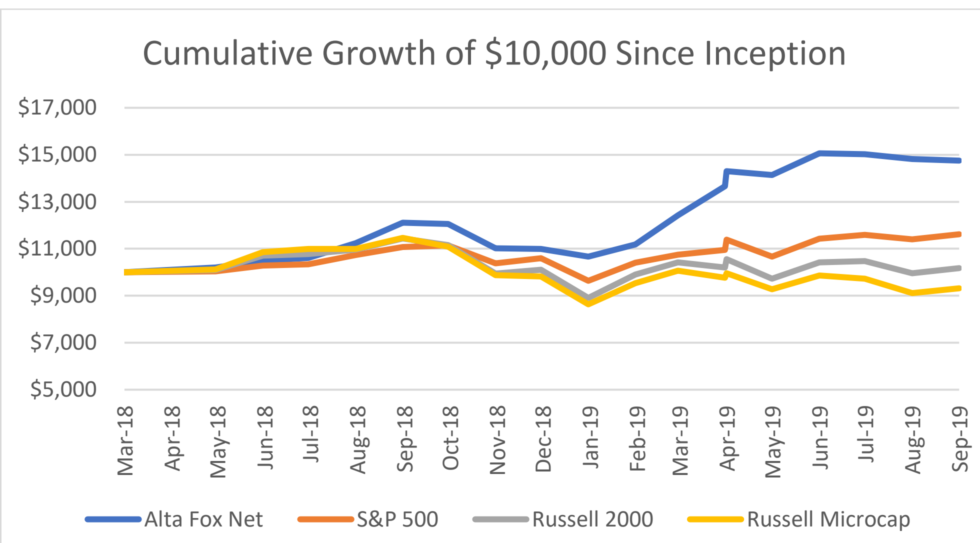
Monthly and Quarterly Fund Returns

	Alta Fox Gross	Alta Fox Net	Alta Fox Net Exposure	S&P 500	Russell 2000	Russell Microcap
Apr-18	2.63%	2.03%	50.24%	0.38%	0.86%	1.25%
May-18	3.56%	2.80%	96.39%	2.41%	6.07%	7.22%
Jun-18	1.45%	1.11%	91.32%	0.62%	0.72%	1.30%
Q2-2018	**7.82%**	**6.05%**	**79.31%**	**3.43%**	**7.75%**	**9.97%**
Jul-18	7.36%	5.91%	80.92%	3.72%	1.74%	-0.07%
Aug-18	9.53%	7.77%	81.12%	3.26%	4.31%	4.30%
Sep-18	-0.41%	-0.40%	94.28%	0.57%	-2.41%	-3.26%
Q3-2018	**17.12%**	**13.68%**	**85.44%**	**7.71%**	**3.58%**	**0.83%**
Oct-18	-10.16%	-8.55%	83.03%	-6.84%	-10.86%	-10.90%
Nov-18	-0.22%	-0.25%	71.48%	2.04%	1.59%	-0.64%
Dec-18	-3.59%	-3.01%	77.19%	-9.03%	-11.88%	-12.05%
Q4-2018	**-13.57%**	**-11.52%**	**77.23%**	**-13.52%**	**-20.20%**	**-22.14%**
2018	**9.13%**	**6.67%**	**80.66%**	**-3.65%**	**-10.94%**	**-13.67%**
Jan-19	6.16%	4.86%	76.97%	8.01%	11.25%	10.49%
Feb-19	13.77%	11.08%	82.10%	3.21%	5.20%	5.48%
Mar-19	12.11%	9.97%	89.95%	1.94%	-2.09%	-2.95%
Q1-2019	**35.41%**	**28.10%**	**83.00%**	**13.65%**	**14.58%**	**13.10%**
Apr-19	5.62%	4.67%	87.00%	4.05%	3.40%	1.91%
May-19	-1.27%	-1.14%	82.29%	-6.35%	-7.78%	-6.74%
Jun-19	7.77%	6.53%	81.06%	7.05%	7.07%	6.19%
Q2-2019	**12.39%**	**10.23%**	**83.45%**	**4.30%**	**2.10%**	**0.92%**
Jul-19	-0.20%	-0.24%	78.51%	1.44%	0.51%	-1.36%
Aug-19	-1.47%	-1.33%	80.76%	-1.58%	-4.88%	-6.29%
Sep-19	-0.55%	-0.54%	77.94%	1.87%	2.08%	2.28%
Q3-2019	**-2.21%**	**-2.10%**	**79.07%**	**1.70%**	**-2.40%**	**-5.45%**
2019 YTD	**48.81%**	**38.24%**	**81.84%**	**20.55%**	**17.58%**	**12.59%**
Since Inception	**62.40%**	**47.45%**	**81.25%**	**16.15%**	**1.69%**	**-6.83%**
Annualized	**38.20%**	**29.58%**	**10.51%**	**10.51%**	**1.12%**	**-4.61%**

Growth of $10,000 Since Inception

	Alta Fox Net	S&P 500	Russell 2000	Russell Microcap
Mar-18	$10,000	$10,000	$10,000	$10,000
Apr-18	$10,203	$10,038	$10,086	$10,125
May-18	$10,489	$10,280	$10,699	$10,856
Jun-18	$10,605	$10,344	$10,775	$10,997
Jul-18	$11,232	$10,728	$10,963	$10,990
Aug-18	$12,105	$11,078	$11,436	$11,462
Sep-18	$12,056	$11,141	$11,161	$11,089
Oct-18	$11,025	$10,379	$9,948	$9,879
Nov-18	$10,998	$10,591	$10,107	$9,816
Dec-18	$10,667	$9,635	$8,906	$8,633
Jan-19	$11,185	$10,407	$9,908	$9,539
Feb-19	$12,424	$10,741	$10,423	$10,061
Mar-19	$13,663	$10,950	$10,205	$9,764
Apr-19	$14,301	$11,393	$10,552	$9,951
May-19	$14,138	$10,670	$9,731	$9,280
Jun-19	$15,061	$11,422	$10,419	$9,855
Jul-19	$15,025	$11,586	$10,472	$9,720
Aug-19	$14,825	$11,402	$9,961	$9,109
Sep-19	$14,745	$11,615	$10,169	$9,317

Cumulative Return	**47.45%**	**16.15%**	**1.69%**	**-6.83%**
Annualized	**29.58%**	**10.51%**	**1.12%**	**-4.61%**



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