

January, 2022

Dear Partners,

For the fourth quarter of 2021, an investment in Class A shares of Laughing Water Capital (“LWC”) returned less than 1% vs 11.0% and 2.1% for the SP500TR and R2000 respectively. For the full year, LWC returned approximately 39%, vs. 28.7% and 14.8% for the SP500TR and R2000 respectively. I remind you to please see your individual statements as results will vary across class and fund.

As always, I encourage you to ignore the indexes over shorter periods of time. We are deliberately choosing to do something different than the indexes, so there is no reason to expect results that align with the indexes. At times we will underperform, and at times we will outperform, but at all times I will do my best to think and act independently. Over longer periods of time, I believe that we will be rewarded for taking an unconventional approach and separating ourselves from the herd. So far so good on that front, as since inception ~6 years ago, Laughing Water Capital has generated a 29% CAGR, while the SP500TR and R2000 have generated 19.3% and 15.5% respectively.

When considering this multi-year performance streak, there is good news and bad news.

The bad news is that it would be a mistake to extrapolate this level of returns into the distant future. While our relative performance indicates that we have benefited from security selection and portfolio management, our absolute performance has clearly benefitted from a strong market backdrop that simply cannot go on forever.

The good news is that in my view, our performance going forward could be considerably weaker than our past performance, and we could still generate returns that would please us. For reference, a 15% CAGR over 30 years results in a ~66x return. The key will be to continue to disregard the short-term gyrations of the markets, and instead seek out anomalous investment opportunities that present the opportunity for acceptable returns over multi-year periods. As a reminder, I am often buying ownership stakes in businesses that are dealing with some sort of operational, optical, or structural problem that I believe a properly incentivized management team can overcome in the not-to-distant future. As our businesses transition past these problems, we should be rewarded by the dual tailwinds of improved fundamentals, and improved sentiment.

Potentially also in the good news column, just because the market cannot continue to rip higher forever does not mean that it has to crash in the near term, although recent market action has not inspired confidence. As always, there are things to worry about, with inflation and a rising interest rate environment being high on the list these days. These are hard problems worthy of monitoring. However, I remain confident that if we simply invest our capital in good businesses, led by properly incentivized people, at times when the businesses are misunderstood and mispriced by the market for easily explainable reasons, we will continue to do well over reasonable periods of time. For this reason, almost the entirety of my and family’s wealth remains invested in our strategy. Our interests are aligned.

Factors, the Value Spectrum, & Diversification

With a ~28% headline return in 2021, the market had another fantastic year. However, looking beneath the surface shows that many stocks struggled. In fact, according to Goldman, more than half of SP500 returns since April came from the five most popular tech names, while many other names were down 20-40+%.

The punditry has declared that a rotation from growth to value is underway, as rising interest rates decrease the value of cash flows that may only exist in the future (growth companies) and increase the value of cash flows that exist in the present. This has led to the air being taken out of anything “growthy.” The other factor that has been driving the market’s narrative is size, with small cap stocks noticeably lagging large cap – and especially mega cap.

What does this mean for us?

On size, I continue to think that we are best able to flex our competitive advantages as an investment partnership in the smaller cap sections of the market, despite the broad brush strokes of factor investing, which are currently a challenge for small caps. On growth, while we haven’t owned any of the most egregiously valued growth stocks, our portfolio has not been immune to this shifting tide, and several of our stocks declined severely in the latter months of 2021. Yet, we still had strong returns for the year.

Our portfolio construction is not foolproof, but it is designed in accordance with my view that value exists on a spectrum, from stocks that are undervalued on an asset basis (discount to book or NAV) to stocks that are undervalued on an underappreciated growth basis. It is no secret that over the last decade “growth” has greatly outperformed “value,” and once lauded value managers have struggled. It is entirely possible that over the next decade, the superstars of the past decade who were invested heavily in growth (and were well rewarded) will struggle.

It is my intention that on a portfolio level we will never be entirely beholden to any one valuation factor, and that we will remain diversified across this value spectrum. Over the last 6 years, our investments that have been more clearly traditional “value” have not performed as well as our investments that have more of a growth element to them, and it is entirely possible that over the next 6 years, our investments that have more of a growth element will struggle to keep up with our more traditional value investments.

What I don’t want to have is a portfolio of ~15 stocks that appears to be reasonably diversified, while in fact all 15 of those stocks are different takes on the same bet. What I do want is ~15 stocks that are diversified not only across industries and macro exposures, but also on market perception, probable event path, range of potential outcomes, and growth potential. I do not intend to attempt to jump back and forth from what is currently not “working” to what is in favor, so quite naturally we will typically have a portion of our portfolio that is not working... until the pendulum inevitably swings.

More broadly, as has been the case in the past, I expect that going forward the bulk of the portfolio will be made up of companies that are essentially the orphaned stepchildren of traditional “growth” and “value” definitions.

For example:

I believe that **Aimia (AIM.TO)** trades below the value of the cash that will soon be on their balance sheet, suggesting Aimia is a value stock. I also believe that Aimia's portfolio company Trade X is growing 300-400% per year, and could be worth more than the entire enterprise value looking out a few years, which suggests that Aimia is a growth stock.

Whole Earth Brands (FREE) equity trades at less than 8x my estimate of normalized FCF, while peers trade at more than 20x, suggesting that it is a value stock. Whole Earth Brands also almost doubled their revenue over the last year or two, and intends to continue to grow through acquisition, suggesting it is a growth stock.

Thryv Holdings (THRY) owns the Yellow Pages, a clearly declining yet cash-gushing asset, which puts it firmly in the value camp. It also owns a profitable small business SAAS product that is growing 40%+ a year, which suggests it is a growth stock.

In my view, seeking out opportunities such as these greatly increases the odds of future success because we can have the best of both worlds: potential growth that we are not really paying for. Further, there is often a self-fulfilling prophecy element to investments such as these, because combining elements of growth with elements of value often leads to misleading financial statements. This prevents the quantitative strategies that dominate the markets from finding these opportunities, which helps explain why they are mispriced. Over time, as the growth elements of these investments mature, the financial statements should become more reflective of what is happening under the surface (either organically, or through deliberate effort by management such as spinoffs etc.) and we should be well rewarded. The key phrase however is, "over time." Over shorter periods of time misleading financial statements can be a liability, and there is no reason to suspect that our collection of idiosyncratic investments will be immune from market turmoil.

In summary, if we continue to do what we always do – focus on good businesses, led by good people, during times of uncertainty or transition tied to some sort of optical, operational, or structural problem – I suspect we will be well rewarded, not withstanding inevitable bumps in the road.

New Positions

Countryside Partnerships (CSP-LN) – Countryside Partnerships, until recently known as Countryside Properties, is a U.K. based homebuilder that is in the midst of transitioning from a model that was one part asset light and one part asset intensive, to a pure play asset light model.

In brief, traditional homebuilding is a capital-intensive enterprise, as homebuilders must tie up capital in land, and then spend an unknown period of time seeking permits, finding buyers, and actually building houses. U.S. industry darling NVR, Inc. (NVR) pioneered an asset light approach to homebuilding following its 1993 bankruptcy, whereby rather than purchasing land (which caused their bankruptcy), they shifted to purchasing options on land. This approach greatly improves ROIC, and frees up capital that can be used to repurchase shares. As a result, NVR has compounded capital at 20+% for decades.

Countryside's Partnership business rhymes with NVR's approach in that it is asset light. Unlike NVR where land is optioned, Countryside's Partnership business enters into joint ventures with local housing authorities, where the Local Authority contributes the land (which has already been permitted) to the JV, and Countryside contributes their housebuilding and community development know-how. Also of note, Countryside typically only takes sales risk for 30-40% of the homes in a development, with ~20% being pre-sold to financial backers that intend to place these homes in the rental market, and ~40% of homes being earmarked as "affordable" and owned by the Local Authority. The fact that 60-70% of homes developed by Countryside are effectively pre-sold greatly reduces the cyclical aspects of homebuilding for Countryside.

The decision to focus on the Partnerships business was brought about by activist investors, including Chicago based David Capital, a long-standing friend of LWC. While the activist campaign was only recently resolved, it seems clear that the activists intend to run the same playbook that NVR has run so successfully in the United States. As evidence, note that the company has eliminated its dividend, which I believe led to forced selling by dividend focused legacy shareholders, which allowed us to purchase our shares at favorable prices. Additionally, the company has indicated that the proceeds from running off their traditional homebuilding business will be used to repurchase £450M of stock, which at the time of our purchase approximated 25% of the effective float.

The combination of buying from forced sellers and a massive buyback create a favorable backdrop where any sustained downside seems unlikely. At the same time, the company is primed to benefit from a favorable macro backdrop, and exciting opportunities to improve its business.

There are 1.1M households on Local Authority waiting lists for affordable housing, and only an estimated 24,000 Local Authority owned homes are currently vacant. In addition, the UK is chronically short of housing stock, and it is estimated that 250k houses are needed annually to catch up with the shortfall. Simply stated, this capacity does not exist. In order to help fill this need, Countryside has announced plans to double their capacity over the next few years. The company currently operates in 12 regions, with only 5 of them being mature, which will fuel this growth. Importantly, the company has visibility into this future growth as they presently control more than 53,000 Partnership Plots, equal to 10 years of delivery at current rates.

This potential growth combined with a stated intention to aggressively shrink the share count sets up an interesting dynamic whereby if the company executes flawlessly, our investment will do well, but if the company stumbles at times, we will likely do even better over the long term. Subsequent to year end, the company did in fact stumble, as they reported earnings that were well below expectations. To the best of my knowledge, a better mouse trap in the homebuilding industry did not magically appear in the fourth quarter of 2021, and the company's 40 year track record of success remains intact. As such, I believe this stumble was simply part of life in a lumpy industry. I took this opportunity to add to our position, as did several of the activist investors who are driving the company forward. As evidenced by NVR's past success, there is a runway here for sustained outperformance over many years, but much of this long-term success may be pulled forward in the intermediate term as the company executes, and the market recognizes that Countryside aims to mimic the capital allocation success that NVR has enjoyed.

Cannabis Basket

As father to three young children (6, 2 & 1) I have discovered that one of the many joys of parenting is that siblings seem to always want what they don't have. One child will go weeks ignoring a certain toy, until a sibling begins to play with it, and then that toy becomes the only thing they want.

At present, cannabis is still illegal at the federal level in the United States, despite a growing tide of state legalizations and growing evidence that cannabis has clear medical and social benefits. As such, U.S. based cannabis businesses that touch the plant are typically publicly traded in Canada, and most U.S. based financial institutions will not custody these Canadian stocks. We are fortunate that our custodian allows us to hold the Canadian listed U.S. cannabis companies, as they are growing like weeds (pun intended) and appear objectively cheap vs. their growth potential. It is increasingly clear to me that within the next year or three Cannabis will be legalized at the Federal level in the U.S., or at the very least the perception that legality is around the corner will grow.

When that happens, what is essentially one giant special situation will be put in motion. The U.S. players will up-list from Canadian backwater exchanges to the Nasdaq, and be added to indexes. Misleading financial statements that presently prevent these companies from deducting operating expenses before calculating their tax bill will likely be cleaned up. Usurious interest rates will become a thing of the past, and these businesses will benefit from structurally lower financing costs. Additionally, whereas at present only a very limited subset of custodians and brokers will allow U.S. investors to invest in these stocks, the floodgates will open as Robinhood and other retail focused platforms will allow access to cannabis for the first time. I believe all of these elements will make the cannabis space akin to the toy that my children only want because they can't have it, and the stocks will re-rate meaningfully higher.

While there are enormous structural tailwinds, it is also not clear to me what the ultimate margin structure in this industry will look like, or which companies will wind up as winners. As such, I am taking a basket approach, choosing to own smaller positions in several businesses, each of which has multiple pathways to success. It is also not clear to me that we will own these businesses long enough to be party to the ultimate margin structure and winners and losers, as it is at least possible that the euphoria surrounding legalization will cause the stocks to blow past any reasonable valuation. I would also note that on a portfolio level, I am happy to have exposure to something whose intermediate term result will be almost entirely about legalization and interim growth into white space, rather than interest rates or inflation. However, in the near term, I expect that the cannabis space will be extremely volatile. To paraphrase one industry executive who recently noted that over the last few years they have only met with the same 20 or so investors over and over with no new faces, if one large investor in the space chooses to sell or needs to sell, there aren't incremental buyers absent legalization. The inverse of this dynamic is of course that these 20 or so investors will not be willing sellers when legalization happens, so the stocks should go much higher. As always, I am willing to trade short term uncertainty for intermediate to longer term success.

If you are interested in more direct exposure to the cannabis space, I would suggest contacting Aaron Edelmheit of Mindset Capital, as he manages a dedicated cannabis fund. I have known Aaron for almost a decade, and he has an impressive track record as an investor, operator, and author. He has also become an expert in the cannabis space over the last few years.

Top 5 Disclosed Long Positions

Aimia, Inc (AIM.TO) – Long term holding Aimia continues to move closer to the date that Aeromexico exits bankruptcy. When that happens, I believe that Aeromexico will purchase the ~49% of PLM (Aeromexico’s loyalty program) that is owned by Aimia. The bankruptcy documents suggest that a price of \$375M is in the offing, but I believe there will be additional consideration for balance sheet adjustments. Inclusive of these adjustments, I believe Aimia could walk away from this transaction with more than C\$6 per share of additional cash on its balance sheet. Furthermore, over the next few quarters I expect that Aimia will increase disclosure around investments in Kognitiv and Trade X, potentially including plans to force the market to recognize value through a public offering of shares in these subsidiaries, or through a sale.

Cannabis Basket – Introduced above.

Countryside Partnerships (CSP.LN) – Introduced above.

Houghton Mifflin (HMHC) - Houghton Mifflin, the largest provider of K-12 instructional materials in the U.S., was introduced in our 1H’21 letter, and there is a slide deck outlining the thesis available on www.laughingwatercapital.com. The market has begun to realize that thanks to drastic changes to its cost structure and an on-going shift toward a digital first approach to education HMHC is no longer the perennial money loser that it once was. In fact, HMHC is now primed to gush cash in the coming years as the country attempts to fill in the learning loss created by Covid. The company has very attractive avenues in which to re-deploy this cash, suggesting that normalized earnings per share could double over the next 4-5 years. Additionally, the company is becoming more predictable as the business mix shifts toward digital and SAAS solutions, which suggests a higher than historical multiple would be appropriate. This combination of increasing cash flow and likely multiple expansion has the potential to reward us for years to come.

However, due its under-levered balance sheet, ability to generate cash, and low valuation, I have long feared that a private equity buyer would buy the company and enjoy the majority of the spoils. In mid-January Bloomberg reported that the company is exploring a sale. From my perspective, given multiple imminent catalysts that could contribute to shares re-rating higher, it only makes sense to explore a sale now if the company already has a bid in hand from a prospective buyer. Private equity has long loved the education space, and given the strategic value of the company’s industry leading salesforce and connected platform, I believe HMHC represents the potential for enormous synergies on both costs and revenue to any potential buyer. The potential for a sale should help insulate HMHC from broader market swings, and we may wind up with a “short term win” with a publicly disclosed buyout offer. However, given the size of the opportunity in front of HMHC, absent a very substantial premium we are happy holders.

Transact (TACT) - Transact, our niche printer company that also houses a fast growing C-store/restaurant back of house SAAS product (BOHA!), was first introduced as Company #1 in our Q1’2021 letter. The company has been executing well, but shares plummeted in the 2nd half of 2021. I believe the sell-off was related to three factors, all of which are temporary. First, management has indicated that due to supply chain problems, they have had trouble securing inventory, and installs have been further slowed by customers’ inability to find labor. This is of course frustrating, but will take care of itself with time. Second, as Covid cases began to spike when the weather turned cold, management filed a shelf offering, which the market took as a sign that the company would be raising dilutive equity capital. I believe the shelf was

filed for emergency use only, because if the world re-entered Covid lockdowns, the company could run into liquidity problems. As it has become clear that there is enormous hesitancy around renewed wide scale lockdowns, I think the risk of an additional capital raise has subsided. Lastly, as shares declined ~40% from earlier highs, the stock became an attractive tax loss sale candidate.

Looking forward, with gentle prodding from 3 activist investors I think it is likely that the company begins to explore a sale of its cash-cow slot machine printer business in the coming year. I believe that this sale could generate proceeds that would cover most of the company's market cap. This cash would then be used to continue to fuel the 100+% growth of BOHA!, which could ultimately be worth multiples of Transact's current enterprise value.

Also of Note

There are three additional names that have been previously discussed that remain within striking distance of our top 5, and depending on which way the wind is blowing on any given day they may be elevated.

PAR Technology (PAR) – PAR, our restaurant technology business, detracted from performance over the past year as growth stocks were broadly punished. However, the company continues to execute, and is likely to sell its defense electronics business in the near to intermediate term, and also continue to expand its restaurant platform offering. With time I continue to believe that PAR will be the most valuable asset in the restaurant space, and that we will be well rewarded for our patience.

Thryv Inc (THRY) – Thryv was introduced as company #2 in our Q1'21 letter. The company continues to execute on growing its nascent SAAS business while milking its legacy Yellow Pages business for cash flow. The company stock continues to suffer under the overhang of a large amount of stock in the hands of an investor who purchased shares during the company's prior bankruptcy, and is presently reducing his position. In the positive column, this seller is selling in part to Thryv's Chairman and CEO who has a long track record of creating value. I believe the signal value of this insider buying by the operator to be much higher than the signal value of the insider selling by a financial owner whose mandate is tied to distressed investing, not fast growing SAAS investing. With time this overhang will lift, and I expect we will be well rewarded for our patience.

Whole Earth Brands (FREE) – There is not much to report with Whole Earth Brands, our "free from" sweeteners business. Management is hard at work digesting recent acquisitions and steering cash flow toward paying down debt. The company remains materially undervalued vs. traditional packaged foods peers, and I have encouraged the company to revamp their marketing efforts toward more ESG focused messaging in an attempt to capture some of the zeitgeist (and resultant huge multiples) attached to other food companies that are seen as re-defining their category. While our partnership is specifically designed to ignore short term price – moves, in this case, a re-rating higher in the near to intermediate term will likely have a multiplicative effect on value creation as in my view at present the company's undervalued stock is not attractive as acquisition currency.

Administrative Matters

Our accountant, Spicer Jeffries, is hard at work on completing our year end audit and K-1s. As in years past, I expect that K-1s will be available with plenty of time to spare before tax day, and our audit will be available for your review on a similar schedule. Please stay tuned.

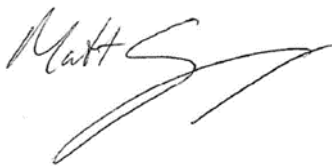
Looking Forward

2022 has started with a fairly severe sell off, which in part explains the delay in getting this letter to you. As always, I have no idea what the market will do in the near term, and I suggest you regard anyone who claims to have the answer with suspicion. I continue to believe that despite the worrisome issues of the day there are still plenty of attractive investment opportunities on a 3-5 year time line. As the market goes lower, these opportunities become more and more attractive, although it certainly does not feel that way at the time. As I have said [before](#), I think the key to long term success at times such as these is behavioral, and in my view a useful way to hijack the millions of years of evolution that encourage us all to panic is to focus on the idea of “cheap enough.” If I can find businesses that are priced to return “enough” assuming some level of normal market behavior at some point in the next 3-5 years, I think it is a mistake to worry about whether or not we could have earned “more than enough” by attempting (and inevitably failing) to pick the bottom.

Broadly speaking, over the last few months I have attempted to better position our portfolio for a rising rate environment. I have trimmed or exited some of our more illiquid positions in order to increase our flexibility, I have increased our focus on investments that should be relatively removed from the broader markets due to their idiosyncratic nature, and I have spent more time looking at international opportunities, where valuations are generally lower.

To be clear, I cannot promise that our portfolio will not go down between now and 3-5 years from now, and I acknowledge that the range of potential outcomes related to inflation and a rising interest rate environment is broader and more varied than the garden variety negatives that always plague the markets and economy. But what I can promise is that I will do my best to faithfully execute the process which has brought us our past success, and upgrade our portfolio during times of volatility. Personally I remain confident that 3-5 years from now we will be well rewarded for our patience.

Please let me know if you have any questions,



MSweeney@LaughingWaterCapital.com
917-306-0461

Disclaimer: This document, which is being provided on a confidential basis, shall not constitute an offer to sell or the solicitation of any offer to buy which may only be made at the time a qualified offeree receives a confidential private offering memorandum (“CPOM”) / confidential explanatory memorandum (“CEM”), 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 CPOM/CEM, the CPOM/CEM 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. This document is not intended for public use or distribution. While all the information prepared in this document is believed to be accurate, Laughing Water Capital, LP, Laughing Water Capital II LP and LW Capital Management, LLC make no express warranty as to the completeness or accuracy, nor can they accept responsibility for errors appearing in the document. An investment in the fund/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 is no secondary market for the interests and none is expected to develop. The portfolio is under the sole trading authority of the general partner/investment manager. A portion of the trades executed may take place on non-U.S. exchanges. Leverage may be employed in the portfolio, which can make investment performance volatile. The portfolio is concentrated, which leads to increased volatility. An investor should not make an investment, unless it is prepared to lose all or a substantial portion of its investment. 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. There is no guarantee that the investment objective will be achieved. Moreover, the past performance of the investment team should not be construed as an indicator of future performance. Any projections, market outlooks or estimates in this document are forward-looking statements and are based upon certain assumptions. Other events which were not taken into account may occur and may significantly affect the returns or performance of the fund/partnership. Any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur. The enclosed material is confidential and not to be reproduced or redistributed in whole or in part without the prior written consent of LW Capital Management, LLC. The information in this material is only current as of the date indicated, and may be superseded by subsequent market events or for other reasons. Statements concerning financial market trends are based on current market conditions, which will fluctuate. Any statements of opinion constitute only current opinions of Laughing Water Capital LP and Laughing Water Capital II LP, which are subject to change and which Laughing Water Capital LP and Laughing Water Capital II LP do not undertake to update. Due to, among other things, the volatile nature of the markets, an investment in the fund/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. The fund/partnership is not registered under the investment company act of 1940, as amended, in reliance on an exemption there under. Interests in the fund/partnership have not been registered under the securities act of 1933, as amended, or the securities laws of any state and are being offered and sold in reliance on exemptions from the registration requirements of said act and laws. The S&P 500 and Russell 2000 are indices of US equities. They are included for informational purposes only and may not be representative of the type of investments made by the fund.