

April, 2022

Dear Partners,

As you know, I prefer to only write twice per year in order to discourage the negative effects that come from discussing our portfolio too frequently. However, as the scary headlines of the day have been a bit more scary than usual lately, I felt an interim update was in order.

Laughing Water Capital “LWC” returned approximately -12.5% in the first quarter of 2022 after all fees and expenses. As always, results will vary based on the timing of your investment, which fund you are in, and which class you are in, so please check your individual statements for a more accurate reading on recent performance. The SP500TR and R2000 returned -4.6% and -7.5% during this time period. In every letter I remind you that there is no reason to expect our results to mirror the indexes because we do not own the indexes, and that is as true now during a period of underperformance as it is during periods of outperformance. In brief, through most of the quarter our results tracked the indexes pretty closely, but as the indexes rallied into quarter end, our portfolio did not. Much of the lag was tied to the large portion of our portfolio that has been invested in special situations or quasi special situations. In my view, these investments have limited possibility of real downside while at the same time they have the possibility for meaningful upside. However, this potential upside is tied directly to these individual companies, and I would be surprised if they got caught up in the short-term momentum of the market. Additionally, I remain confident in those investments that were the biggest drag on our performance over the last 3 months. In each case there is reason to believe that they will perform exceptionally well over the intermediate and long term, despite their recent declines. Over time I suspect we will be happy with the road less travelled.

For this reason, almost the entirety of my and my family’s wealth is invested in LWC. If I can continue to find good businesses, led by good people, during periods of temporary difficulty or transition, I am confident we will continue to be pleased with our investment returns over longer periods of time.

Where Are We Now?

I have often said that there are always things to be scared of when thinking about investing in stocks, but I feel comfortable saying that at the moment there seem to be more things than usual. Between inflation, interest rates, supply chain problems, war in Ukraine, economic sanctions (and their unintended and unknown consequences), not to mention renewed Covid related lockdowns in China (and China possibly being emboldened vis a vis Taiwan) the list is long, and the list of talking heads spouting their opinions is longer still. All of these factors have contributed to small cap indexes entering a bear market from mid-November of '21 to mid-January, and the average stock in the SP500 trading down more than 20%. Further, with the SP500 not that far off of all time highs it may not feel like it, but the small cap indexes are actually down over the last 12 months. Over longer periods of time I continue to believe that focusing on smaller companies as we do comes with distinct advantages. However, at the moment our strategy is facing headwinds from the headlines.

I think it is best to assume that these scary headlines will be with us for some time, and I also think it is best to remember that historically the market has turned higher well before the headlines have improved.

With this backdrop there are a wide range of potential outcomes in front of us. At times such as these – where uncertainty seems to be around every corner – I find it useful to focus on the things that I know for sure rather than the things that are unknowable. Below is a list of things that I know for sure.

- 1) As with every past downturn and subsequent recovery, someone will be held up as the next Cassandra due to their “calls” around near-term market direction. The problem however is that no one knows in advance who will be right, so in my view looking to pundits for hints is a waste of time. Ignoring the noise is a much better strategy.
- 2) Now is not the time to swing for the fences. This is true because it is never time to swing for the fences. Our strategy is conservative by nature.
- 3) Fear is not a strategy. Roughly half the pundits out there are calling for investors to run for cover. There is an enormous amount of evidence to suggest that an investor’s best defense during difficult periods is to know what they own, rather than owning nothing. Many of our businesses have been specifically chosen due to their ability to become stronger during difficult periods. This says nothing about what their stock prices will do, but it does suggest that ultimately our portfolio will be strengthened by temporary difficulty. We should all be willing to trade near term declines for greater long-term gains.
- 4) While the macro backdrop may be unsettling, there are a lot of cheap stocks available to those who are willing to look through near term uncertainty.
- 5) Ultimately, process will prevail. All I am trying to do is tilt the odds for long term success as heavily in our favor as possible by focusing on good businesses, led by good people, when they are dealing with some sort of temporary problem or inefficiency that can be solved given enough time. If our businesses execute, we will be rewarded. Eventually.
- 6) The greatest advantage an investor can have is a long timeline. All of recorded history suggests that “this too shall pass,” and investors will be well rewarded for their patience. In the near term, owning cheap stocks is not a defense against macro calamity. However, over reasonable periods of time individual business performance will trump macro conditions.
- 7) If history is any guide, at some point in the next 3-5 years our businesses will be valued on a normalized multiple of their normalized earnings power. In some cases my estimate of the normalized multiple will be wrong, and in some cases my estimate of their normalized earnings power will be wrong. However, on a portfolio level I believe we will be well rewarded for staying the course through whatever volatility comes in the interim.

All of the above can really be boiled down to the fact that neither I nor anyone else knows what will happen next. However, while the macro backdrop is a bit unsettling, in my view there are a lot of cheap stocks out in the world right now. That does not mean they can’t get cheaper, but for those investors who are able to remain focused on the long term while ignoring the short term bumps in the road, I continue to think we will be well rewarded with time.

We are in good company in this view. About half of our portfolio companies have recently seen insiders adding to their positions by buying shares in the open market, and about a third of our portfolio companies have been taking advantage of recent weakness and repurchasing their own shares. While I am confident they have no better knowledge of what will happen next month or next quarter or next year than I do, I also think it is likely that with time their decision to purchase shares at this time will be rewarded.

Portfolio Updates and Renewal

Aimia Inc (AIM-TO) – Aimia, our Canadian holding company, announced terms under which its minority investment in PLM, Aeromexico’s loyalty arm, will be sold to Aeromexico. At present the stock trades a touch above C\$5.00 per share, and at some point in the coming months Aimia will receive C\$5.58 cash per share in proceeds. The company has committed to returning \$75M of this capital to investors through share repurchases, which suggests downside protection for Aimia stock. At the same time, the company has begun to increase disclosure around its other investments, which should increase investor awareness and drive shares higher with time.

Cannabis Basket – The best proxy for cannabis stocks, the MSOS ETF, was down more than 20% in Q1, and our cannabis basket was a material drag on our Q1 performance. Despite this recent decline, cannabis businesses continue to grow, improve their financing, and march closer to the day that cannabis is legalized at the federal level. Until that day I expect that the stocks will continue to trade primarily on fund flows, which in my view should mostly be ignored. We own cannabis stocks because I believe their performance in the intermediate term will be almost entirely tied to legislative proceedings, and entirely removed from economic concerns.

Countryside Partnerships (CSP-LN) – Countryside, our UK based homebuilder that is in the process of running off its asset heavy division in order to focus on its asset light division, was introduced in our [YE’21 letter](#) as a large position. I also spoke about Countryside in a recent interview I did with [Sunday’s Idea Brunch](#). In brief, thus far this investment has been a disaster as the company has been “kitchen-sinking” bad news under new leadership. While this is a painful mark to market loss that is responsible for much of our recent underperformance, the reality is that for patient shareholders this near-term pain is the best thing that can happen in order to drive long term outperformance.

Countryside – at the behest of activist investors – has committed to using the proceeds from running off their asset heavy division to repurchase shares of the company. They are not re-inventing the wheel here. In fact, they are shamelessly cloning the behavior of NVR, Inc. (NVR), a U.S. based asset light homebuilder that has compounded capital at 20+% per year for decades. With a stated goal of shrinking the float, the lower the stock in the near term, the higher it will be in the long term, assuming that the business is not irreparably damaged. New management has been transparent about the challenges they have inherited, and their plan to correct them. Thus far, my read is that none of these challenges are insurmountable, although I am actively trying to challenge that view. At current prices I estimate that the company will be able to retire ~36% of its remaining total float through repurchases. However, when adjusting the float for activist shareholders who have been using weakness to increase their investment, the company is primed to repurchase almost 50% of the available float over the next ~2 years.

Importantly, homebuilding is a business that has not changed all that much in the last several hundred years, and I don’t think we have to fear disruption over the next year or two. This means that as long as the business just muddles along over the next 2 years and management corrects the problems they have identified, we should be well rewarded. However, the company has also laid out plans to double their earnings power as they expand into new geographies and right size operations. There are sure to be additional bumps along the way, but when your near term downside amplifies your long term upside, in my view there is little reason to worry... assuming you can remain patient.

Houghton Mifflin (HMHC) The most notable events for our portfolio over the past quarter were related to our investment in Houghton Mifflin, our K-12 curriculum business, which I detailed in a [slide deck](#) last September. In mid January Bloomberg reported that HMHC was exploring a sale. Believing that HMHC could be worth as much as \$30 per share to a strategic buyer and with shares trading around ~\$18, I brought HMHC to max position size for us. In late February it was announced that private equity firm Veritas Capital planned to buy HMHC through a tender offer for \$21.00 per share. In my view this price was woefully inadequate, and I issued a [letter to the Board](#) explaining my reasoning. Three other shareholders also publicly objected to the transaction, and when the Tender Documents were made public, it became clear to me that the process to sell HMHC was flawed. Specifically, in the early rounds of the sale process, HMHC presented potential buyers with a set of financial projections that were in my view non-sensical, only to later present a revised set of financial projections that were significantly improved. However, all but 2 potential buyers had dropped out of the process before the updated projections were made available, and these other potential buyers were not presented with the updated projections.

My early diligence on HMHC suggested that the board of directors, which is made up primarily of education types rather than business types, was weak, and that the management team had outsized influence with the board. I cannot know for certain, and I am certainly not making any accusations, but it seems possible that HMHC's management team deliberately ran a sale process with flawed projections so that they could remove themselves from the public markets, regardless of price. When one considers that it is not uncommon for management teams to earn 5-10% of the value of a private equity transaction, it seems possible that HMHC's management team chose to earn ~\$100M for themselves rather than maximize the value of the business for the benefit of all shareholders. I am quite confident that the private equity buyer will ultimately make billions of dollars by combining HMHC with another of their portfolio companies, Cambium Learning, and eventually taking the combined business public once again. Making this even more painful for us, all of our considerable gains in HMHC will now receive short term treatment from the IRS.

Thryv Inc (THRY) – Thryv, our company that has been using their declining Yellow Pages business as a base from which to build a cloud-based software product that allows small and medium businesses to greatly improve efficiency, traded down by about 30% in the first quarter. Subsequent to quarter end the company hosted an investor day where for the first time they presented their vision of the future. In brief, they laid out a plan to more than 5x SaaS revenues by 2027, and then 4x revenues again by 2032.

I am of course skeptical of this level of growth, but the trend of small businesses digitizing their operations is undeniably in very early days, providing an attractive playing field. Further, the management team here has an excellent track record of past success. CEO Joe Walsh and his team have been together for more than 20 years, and in that period they built one company from \$20M in revenue to \$2B in revenue, and led another company through a SaaS transformation that saw the share price go up 20x. Today's undemanding valuation means that Thryv can fall well short of their goals (and management's past success) and we should still be handsomely rewarded. If they are able to execute in-line with their expectations, the investment will be a grand slam. Importantly, they have already proven that this business can generate cash; if growth disappoints they can simply de-emphasize growth spending and focus on cash flow.

One might question why this opportunity exists, and in my view the answer is simple. THRY recently emerged from bankruptcy (caused by the declining yellow pages business and too much debt), and the distressed debt owners who shepherded the company through this bankruptcy have been selling their shares. I would not consider them to be forced sellers, but I would consider them to be structural sellers, rather than economic sellers. Simply stated, they are in the business of investing in distressed debt, not growing software companies. These shareholders still own ~25% of the company, which is a clear overhang that prevents short term focused investors from buying shares, and a clear impediment to liquidity that will make THRY attractive to larger investors.

Additionally, the GICS investing databases that power stock screeners classify Thryv as a Communication Services business that is focused on Advertising, because that is where the Yellow Pages business belongs. At some point, the market will realize that the Yellow Pages is a useful cash machine, but the real engine of the business is SMB software, and the stock will be more appropriately classified as an Information Technology company focused on Application Software. As a reminder, according to JP Morgan 80% of market participants these days are relying on mechanical screeners and quantitative inputs to drive their decision making. That means that on some level, 80% of market participants view Thryv as a dying advertising business rather than a fast growing, high margin, low churn, recurring revenue software business. I was reminded of this just the other day when I was speaking to a partner at a well-known tech focused hedge fund that prides themselves on knowing the entire tech universe. They had never heard of Thryv because it does not screen as software. When this classification changes, perception will also change, and I expect shares will trade higher.

Despite all these positives, I would be remiss if I did not also add that with their focus on small and medium businesses THRY's customer base is more economically sensitive than our typical investments. However, given the upside cases and current valuation, I think we will be well served to ignore the economic sensitivity and focus on what this business could look like in 5 years time.

Transact Technologies (TACT) – Transact, our back of house restaurant software company and slot machine printer company, traded down by about 30% in the first quarter. At present the company is dealing with supply chain issues that will slow its growth, but management recently announced one large new customer win, and indicated that they are close on two more. The gating agent is supply of their product. Eventually these delays will clear, paving the way for a bright future. More important than price action, at quarter end the company agreed to add two new members to its board of directors at the behest of activist investors. The addition of the activists to the boardroom will improve corporate governance, and likely increase the odds that Transact's legacy slot machine printer business will be monetized. When that eventually happens, it is likely that the market will look favorably on what will then be a pure play fast growing recurring revenue business.

Broadly speaking, our companies are continuing their march forward to a brighter future when they will move past the temporary operational, optical, or structural problems that allowed us to buy them on sale. It is reasonable to expect that not all of them will meet expectations, and it is a near certainty that I have made some mistakes in my analysis somewhere. Never the less, as a whole I think our portfolio is well positioned. Additionally, while frustrating, our forced sale of HMHC has left us with a cash windfall at an opportune time. I have begun redeploying this cash into a new generation of investments that I believe

will fuel future gains for us. Please stay tuned for additional details on these new additions to our portfolio.

On Oil, Energy, and Commodities

There is a strong case that oil, energy, and other commodity stocks are set up for a boom period. I have considered investing in this arena by way of a basket strategy, but thus far I have not made any investments, and if these stocks do (continue to) soar, we will not participate. My hesitancy is based on 1) a belief that while at times these businesses can gush cash, ultimately they are not very good businesses 2) in this arena success is largely based on timing, and 3) conversations with sector experts who are cautious, while market generalists (many of whom are very smart) are pounding the table.

Ultimately while I think there are good odds that those that invest in these spaces will be well rewarded, I also think that these bets are more binary than most appreciate. I am not interested in binary outcomes. I am however always interested in expanding my circle of competence, and it is possible we will own some businesses or have some other exposure in oil, energy and/or commodities in the future.

Omaha / Berkshire Hathaway Meeting

For existing and prospective LPs that will be travelling to Omaha for this year's Berkshire Hathaway meeting, if you would like to find time to meet for a cup of coffee etc., please don't hesitate to reach out.

Growth of LWC & Operational Updates

As of February, my family and I are no longer the largest investors in our strategy. After a four year diligence process, we recently received an investment from a large family office with ties dating back to technological advances made in the 1850s. This is the second large family office that has joined us, and I hope that this vote of confidence gives increased comfort to all LPs. Despite this change, I suspect my family and I remain the largest investors in terms of percent of personal investable assets: we are just short of all in, and our interests remain aligned. Despite this recent growth, we remain below the level where I believe size may become an impediment to our returns, and I am still accepting capital.

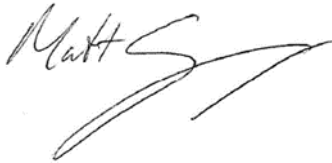
As we continue to grow, I intend to invest back into the business for the benefit and comfort of all partners. In what was the first step toward bringing on a CFO partner to assist with operational demands, I contracted with cLution LLC, to review K1s for accuracy. All partners should have received their K1, prepared by our tax & audit provider, Spicer Jeffries, in mid-March. If for some reason you have not received your K1, please let me know.

Looking Forward

As always, I have no idea what the market will do in the near-term. However, I remain as excited about our long-term prospects as ever, and believe that our current investments are priced to provide intermediate and long term returns that will please us. In my view it is a better use of time to focus on these investments, our management partners, and the problems they are facing than it is to focus on the scary headlines of the day, even if those headlines are scarier than normal. After all, the headlines themselves are less important than whether or not those headlines are priced in.

This is not to suggest that at present they are fully priced in: I truly have no idea. Neither am I suggesting that sticking one's head in the sand and completely ignoring the macro conditions around is the right strategy. However, as the current risks are so widely known, on some level that should give us comfort. Ultimately, if we are able to pay low prices today for businesses whose earnings power will greatly improve over the next few years, we will eventually be rewarded regardless of what else happens in the world. As I have discussed in the past, the key is believing that our current investments are "cheap enough" to please us in the long term. We should not be bothered if they become cheaper still in the near term. Additionally, due to the forced monetization of our investment in HMHC we are sitting on a large cash position that will allow me to rejuvenate the portfolio at an opportune time. In my view, there are many exciting opportunities available.

Please let me know if you have any questions,



MSweeney@LaughingWaterCapital.com
917-306-0461

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