January, 2024

Dear Partners,

For Q4 2023 Class A interests in Laughing Water Capital returned approximately 3.2%, bringing our year to date returns to approximately 11.8% after all fees and expenses.[i] The SP500TR and R2000 returned 11.7% and 14.0% for the quarter, bringing year to date returns to 26.3% and 17.0% respectively. Since inception, LWC has returned approximately 245%, vs. 193% for the SP500TR and 118% for the R2000. As always, please check your individual statements for the most accurate reading on returns, as returns will vary based on class, fund, and timing.

In nearly every letter I have written, I have reminded you that over shorter periods of time the indexes are of little use to us because I am deliberately choosing to do something different than the indexes. That is as true today as it ever has been, but it is admittedly more difficult to issue this reminder when we trail the indexes.

My focus on small and very small cap stocks has done us no favors of late, as large stocks have significantly outperformed small, and small have significantly outperformed very small (for reference, the IWC Micro cap ETF returned ~8% in 2023). However, I would be remiss if I were to blame our returns on index activity. I manage a concentrated portfolio, where security selection and portfolio management will ultimately drive returns. In good times, it is easy to see that this strategy is the surest path to long term outperformance. Deliberately choosing to be different than the index is the only way to beat the index, and small amounts of outperformance compounded over longer periods of time lead to large differences in ending sums.

In times when we trail the index it is harder to see the wisdom of this approach if we rely only on stock prices as our lens.

The area that is more deserving of our gaze is fundamental business performance. If I am able to identify businesses whose normalized earnings power goes up over time, the market will reward us eventually, as long as I don't over pay at the outset. In this regard, 2023 was a very good year, as our businesses executed well, even if the reaction in their stock prices did not correlate well to one trip of our planet around the sun. This delayed gratification is in some cases tied to change that has not yet manifested itself in GAAP financials, in some cases it is tied to the market's myopic focus on short term macro concerns, and in other cases it is tied to a series of idiosyncratic "bad outcomes/one off events" that hit our portfolio to a degree that statistically boggles the mind this year, while not impacting the long-term value that I see.

In all cases I remain confident in the future earnings power of our businesses and the management teams which will help bring this latent power to the surface with time. For this reason, almost the entirety of my and my family's wealth is invested right alongside yours. Fundamental improvement will not be ignored forever.

Value, Path Dependency, & Grandma's House

I live with my wife and three small children about 40 minutes outside of New York City. This is far enough away to be well removed from the non-stop activity and energy of the city, but close enough to still have everything we do be affected by traffic. My parents live on average 2 hours away in one direction, and my in-laws live on average 2 hours away in another direction. As I am committed to making sure my kids see their grandparents with some frequency, the Sweeney family is no stranger to long trips in the car.

As anyone with kids knows, long car rides and little kids are not a great match. The typical experience might entail anything from bathroom breaks on the side of the road, to car sickness, to not having the right snacks, to arguments about whose elbow is touching whose. Of course, the soundtrack to all of this is a non-stop chorus of "are we there yet?"

The experience can be challenging for everyone involved, especially the kids. Yet, my kids manage through by staying focused on the destination. Whatever difficulty comes with the journey becomes worth it when they are greeted by junk food, different toys, hugs, later bed times, and new adventures upon arrival.

My approach to valuing a business assumes that at some undefined point in the future Mr. Market will put a "normal" multiple on "normal" free cash flow. In this instance "normal" means a hypothetical world where the variables that drive business performance are neither too favorable nor too punitive. This normalized valuation would then of course be adjusted for future share count and balance sheet items to arrive at a per share equity value at some point in the future.

Absent interim returns of capital, my ability to predict these four variables (free cash flow, multiple, share count, balance sheet adjustments) within a reasonable range a few years from now will determine our investment success. Of the four, I believe that future free cash flow is by far the most important. Although obvious exceptions apply, I view future balance sheet adjustments as the least important.[ii]

It should come as no surprise then that I deliberately focus on opportunities where I believe a Company's competitive advantages, management skill, and industry trends provide a strong indication to where future earnings power is headed. However, if our goal is outsized investment returns, by definition there must be a fair amount of uncertainty around how the business will get to this future earnings power. Otherwise, the market would price that future success today, leaving the only path toward outsized returns as exceeding expectations.

Planning on doing better than planned is not a good plan.

This path dependency risk will ultimately manifest itself in future balance sheet adjustments. If the path toward future earnings is smooth, the future balance sheet will have more cash / less debt, resulting in greater value to the equity. If the path toward future earnings is bumpy, the future balance sheet will have less cash / more debt, which will eat into equity value. In both cases, the overwhelming bulk of the future value will be tied to how much cash the business can generate at a point in time, how durable that cash is (the multiple), and how that cash is divided (the share count).

I think this approach makes the most sense if our goal is long term outperformance, but in a market that is increasingly short term focused, this view is at odds with the masses, and clear fundamental

improvements in longer term earnings power can be given a back seat to macro concerns, short term fluctuations in quarterly earnings, or one-time unexpected events. I often think of investors in Walmart in the 1970s that sold their shares due to fears that inflation and higher interest rates would have a negative impact on the business. These investors likely felt smart for a period as they sidestepped a drawdown. But was it worth it? Within a few short years it was clear that Walmart's earnings power was considerably higher, and the stock price followed suit. The amount of cash that did not accrue to the balance sheet due to higher rates and inflation quickly became insignificant. Selling the stock was likely a huge mistake. There are countless other examples as well.

And yes – I am cherry-picking this example. As a reminder, I am managing a concentrated portfolio; I am in the cherry-picking business. This is not to suggest that our companies will prove to be as successful as Walmart (although there are some candidates), but they do not need to be as successful as Walmart for us to do very well with time. All they need to do is demonstrate that their earnings power can be significantly higher a few years from now.

A number of our stocks were held back by similar short term concerns this year. For example, Thryv Inc (THRY) grew customer count by 29% YoY through Q3, yet the stock was flat on the year. The problem? Thryv has floating rate debt, and in a rising rate environment more cash must be used to service the debt. At the same time, they are quickly paying this debt down, and interest rates will not slow the inevitable trend of small businesses modernizing their operations through software. A few years from now the normalized earnings power of the business will swamp the importance of the increased interest payments this year.

Another example is Hilton Grand Vacations (HGV), also flat on the year. The problem? Wild fires in Maui prevented travel to HGV's resorts in the area, and the Company was forced to cut guidance. At the same time, the Company announced an acquisition that I believe will drive earnings power ~30% higher 2-3 years from now. I am quite certain that Maui will remain a popular destination at that time, and the wild fires will be but a memory.

If I felt these stocks were "kinda cheap" it would make sense to try to avoid the bumps and re-allocate to more attractive investments; opportunity cost is real. But I think these stocks are very cheap, and at some point will rapidly make up for a lost year of returns. Patience is the key.

When faced with situations such as those described above – and there were others this year as well – it seems clear that the best path forward is to remain focused on the destination, and disregard the bumps on the road along the way. If we can do this, the rewards will be quite a bit more substantial than junk food, different toys, hugs, later bed times, and new adventures.

New Position: Putting The Band Back Together

Nextnav Inc. (NN) – There is a lot to hate about Nextnav. On the surface it is a busted SPAC that consummated a merger with an investor presentation that tied the value of the go-forward company to flying taxis. Flying taxis are miles away from my core process, so one may wonder how NN made its way into our portfolio.

Nextnav owns the rights to 8 MHz of wireless spectrum in the 900 MHz band which has been earmarked by the federal government for Location and Monitoring Service (LMS). What this means in practice is that the Company has two business lines, one which adds vertical axis capability to the existing GPS network (what floor of a building you are on) and one that is a next generation GPS system, that unlike its predecessor is encrypted, making it difficult to spoof, and the signal is much more powerful than existing GPS, making it difficult to jam. The federal government and first responders have made it clear that the development of these technologies is a priority, and the recent conflicts in Ukraine and Israel/Gaza have put a spotlight on the shortcomings of the existing GPS system. And yes, in theory if the world will someday have flying cars, the vertical axis would be important.

However, I am not sure how to value these business lines. In fact, a recent short report by a well-regarded short seller laid out the challenges faced by them, as well as the competition. Where it gets interesting though is that NN has been running tests to validate the idea that they can run their LMS businesses on a small portion of their owned spectrum, and then repurpose the remaining spectrum for 5G broadband. This spectrum could then be sold or leased by NN to anyone from the large cellular companies, cable companies, or tech companies.

The FCC has made it clear that they want more spectrum available for broadband, and the laws of physics means that no one is inventing more spectrum. This is low band spectrum, which while it can carry less data than mid-band or high-band, can travel further and more effectively penetrate obstacles such as dense tree cover or urban environments. It covers 93% of the U.S. population, and in industry terms NN has 2.4 billion MHz-Pops, meaning the amount of spectrum multiplied by the population in their coverage area. If we assume that NN will need to retain 1 MHz for their LMS businesses, and ascribe no value to these businesses, we purchased our shares in NN for less than 30 cents MHz-pop. This compares to past transactions and industry experts that suggest this spectrum could be worth anywhere from 2x to 7x or more depending on event path, timing, and the potential that the FCC demands windfall payments in a sale. For me, focusing on the bottom end of the range is enough as even disappointing outcomes suggest that NN is severely mispriced. At the same time, the top end of the range could be exceeded depending on how competitive a bid process is, and also because antenna technology is progressing to the point where adding new spectrum to an existing antenna can be done by software upgrade rather than hardware upgrade. In theory, this reduction in necessary CapEx means that a buyer of spectrum could pay more for the actual spectrum while maintaining their ROIC.

Where it gets even more interesting is the people that are involved. The shareholder registry and list of insiders are a "who's who" of spectrum operators and investors. Notably, they have "put the band back together" as it relates to a previous investment in Straight Path Communications Inc. an owner of high band spectrum, which was sold to Verizon (VZ) in 2017 for $184 per share approximately 18 months (deal announcement) after a negative report from a well-regarded short seller caused shares to trade around $7. The band leader can perhaps be thought of as Neil Subin, who manages the family office of the late Lloyd Miller III, who was regarded by many to be perhaps the best small and microcap investor ever. A partial list of Subin's credentials as an investor in spectrum can be found below:

- Chairman and major shareholder of Teletrac, Inc, a developer of vehicle tracking and location systems through wireless spectrum and holder of FCC licenses in the 900 MHZ band.
- Director and large shareholder of Nucentrix Broadband Networks, Inc., a wireless broadband access provider and holder of FCC licenses in the 2.5 MHz band.
- Director and large bondholder of Metrocom Wireless Inc., a consumer electronics provider and holder of FCC licenses in the 2.3 MHz Band.New CEO November.

- Director and large shareholder of WCS Wireless LLC, a manufacturer of communications equipment and substantial holder of FCC licenses in 2.3 MHz band.
- Largest shareholder of Mpower Communications Corp., a competitive local exchange carrier.
- Chairman of the Board, Director, and large shareholder of First Avenue Networks Inc., a wireless backhaul provider and holder of FCC licenses in the 39 GHz band.
- Director and large shareholder of CCTV Inc. a holder of FCC licenses in the 1.4 MHz band.
- Chairman of the Board and large shareholder of Primus Telecommunications Group, Inc., a diversified telecommunications holding company with interests in competitive local exchange carriers, wireless access and VOIP in the U.S., Canada and Australia, and holder of Canadian 2.5 MHz licenses.
- Director and large shareholder of 360 Networks Inc., an owner of a substantial fiber network.
- Large shareholder of U.S. Telepacific Holdings Corp., a large competitive local exchange carrier.
- Director of the Leap Wireless International Inc. Liquidating Trust.
- Director of the Iridium Communications Inc. Liquidating Trust

Needless to say, Subin knows a thing or two about spectrum; he is not here for the flying cars. Importantly, the SPAC announced their merger with Nextnav only nine months after its IPO – it is clear this was not a case where the SPAC sponsors were forced to settle for a subpar deal because of a limited time line. Additionally, it is notable that at the time of the transaction, when NN shares were trading at ~$10, Subin said:

> *We believe that this is a 100 year plus asset that will drive innovation, enable the global economy, and produce significant free cash flow for decades to come* ***that I believe we are creating at or below underlying spectrum value****."*[iii] *(emphasis mine).*

I expect that within the next few weeks Nextnav will formally ask the FCC to repurpose a portion of their spectrum away from LMS and toward broadband. This by itself should be seen as a milestone as the FCC must grant permission for such requests, meaning that if the request is made, the Company has proof of concept in hand from the tests they have been running in the Bay Area. From there, the timing of an FCC review is uncertain, with anything from a few months to perhaps 2 years being within the realm of possibility. However, the outcome is highly likely to be favorable as the FCC has made it clear that they want more spectrum to be freed up for broadband. Further, my research suggests that Nextnav has the relationships in place and has done the groundwork in advance necessary to expedite the process. Importantly, as long as the world is consuming more data, the value of spectrum should continue to go up with time. Upon successfully "splitting" the spectrum, NN is likely to sell or lease to the highest bidder, which could lead to a dramatic re-rating in share price in the not-too-distant future.

Top 5 Disclosed Holdings

API Group (APG) – APG, which is perhaps best thought of as our fire safety business, continues to execute on their plan to fully integrate their acquisition of European assets, grow organically, and widen margins. Additionally, the Company has paid down debt, which will allow them to restart their M&A engine, which has been a key contributor to past success as they operate in a fragmented industry where there are

benefits to scale. Management and the Board have a lot of skin in the game, and are skilled capital allocators that are likely to find creative ways to drive business value with time. The Company's services are statutorily mandated, and thus largely removed from the ebbs and flows of the macro economy. Management continues to shift their revenue mix toward recurring inspection and service work. With time, these factors should lead the market to recognize that the stock is worthy of a higher multiple, and I believe shares could comfortably double over the next few years.

Lifecore Biomedical, Inc. (LFCR) – I have written extensively in the past on LFCR, our fill-finish contract drug manufacturing organization, so I suspect it is familiar to you. In brief, after a battle with activist investors and a flirtation with bankruptcy, the Company is presently in the midst of a strategic review that I believe will eventually lead to a sale of the business at a significant premium. However, those hopes are on hold as earlier this year the Company failed to file their financial statements in a timely manner. Importantly, all indications are that the delay is due to historical issues that are non-core to Lifecore's go-forward business. This is incredibly frustrating as Lifecore has been a big bet for us, and I cannot think of a way to predict that financial statements that had been previously blessed by an auditor with access to material non public information would later be flagged for review.

However, the Company has provided several updates that suggest that the value of the core business continues to go up as they deal with these legacy issues. This view is confirmed by commentary from other industry participants which suggests that demand for Lifecore's assets remains very high. The lack of financial statements – and in particular an updated balance sheet – is uncomfortable, but we can take comfort from a recent filing that reading between the lines suggests the balance sheet is fine, and importantly included information on increased business with Lifecore's largest customer, Alcon (ALC).I continue to believe that the most likely outcome of the Company's strategic review will be a sale of the business. From current prices, all that is necessary for ~100% upside is for a buyer to put a middling multiple on the Company's initial 2023 guidance, giving no credit for announced new business wins, and substantial capacity additions. I would expect shares to re-rate higher in the near term when current financial statements are filed. All that being said, it seems unlikely that my original upside cases will be hit, as anything that could go wrong has gone wrong, and industry multiples have broadly contracted over the last year. In any case, until such time as the Company becomes current on their financial statements, we are in a holding pattern.

Limbach Holdings Inc (LMB) – Limbach is new to the portfolio for the second time. I first purchased shares in 2017, but sold as the management team continuously disappointed vs. expectations. I purchased shares once again as a new CEO began to demonstrate that not only had he solved the problems of the past, but that he was taking the Company in a new direction.

Historically, Limbach operated primarily as a building contractor focused on large scale HVAC projects. These projects often had attractive headline numbers, but in practice were difficult to execute and frequently not very profitable. About two years ago, the Company began to shift the business toward more predictable, higher margin, Owner Direct Revenue and away from the legacy General Contractor Revenue. Under the Owner Direct model, Limbach partners with building owners to save them money by improving the efficiency of their buildings, and maintaining and servicing their equipment. At present the

business is approximately 50% Owner Direct and 50% General Contractor, up from about 25% when the Company first formally announced the shift in their strategy. Clearly, the strategy is working.

What this means in practice is that gross margins have improved from the mid-teens to the low-mid-twenties, as the Owner Direct model is solidly more profitable. The Company aims to continue this transition, and expects that with time Owner Direct will be ~80% of their business. Part of the original thesis back in 2017 was that Limbach would be a good platform for bolt on M&A, which would help drive earnings growth. There are many examples of construction linked companies that have executed this playbook very well over long periods of time. However, in the case of old Limbach, bolting on businesses to a core business that could not execute was not practical. New Limbach however is at the point where they can start flexing this muscle, and in fact, they made two small acquisitions in 2023. The combination of continuing to improve their mix, growing organically, and growing through bolt on M&A at attractive multiples should continue to drive free cash flow higher over time, and the continued evolution of the business to higher margin, more predictable, less cyclical maintenance and service work should continue to drive the multiple higher. If this happens and Limbach is valued in line with peers, shares can easily double in the not too distant future. A hat tip to Yaron Naymark of 1Main Capital is appropriate as he encouraged me to revisit Limbach.

Thryv, Inc (THRY) – Thryv, our SMB software business that is attached to a declining cash-cow marketing business (the Yellow Pages), had a great year from an operational perspective, having grown customer count 29%, added new centers, and paid down debt. The company also demonstrated that they can flex their operating structure to juice margins when necessary by choosing to rely more heavily on referrals for growth rather than paid search. However, as mentioned previously, it seems as if this year the market only cared about the fact that the Company has floating rate debt, although a wrinkle in GAAP revenue recognition rules that created an air pocket in revenue while not affecting cash flow may also be to blame for the stock's lackluster performance.

Regardless, the Company is approaching the point where their SMB software offering will eclipse their declining marketing business in the not-too-distant future, and the operating leverage characteristic of software businesses will make itself known. Importantly, at that time the Company should be reclassified away from "Communications Services: Advertising" and into "Information Technology: Software" by the GICS system that controls what passive ETFS, quants, and even multi-manager pod-shops are allowed to invest in. This will open up the opportunity to a whole new class of investors, and should lead to a re-rating.

If the Company is able to hit their 5 year plan in 2027 the software business will be generating ~$200M in EBITDA. If Thryv is valued similarly to other scaled SMB software businesses, shares could appreciate by 300-400% from today's levels. At that time, concerns surrounding interest rates will seem silly in hindsight.

Vistry Group PLC (VTY-L) – Vistry, our asset-light UK Homebuilder focused on affordable housing, announced in September they would be exiting their traditional homebuilding business in order to focus fully on their asset light Partnerships business. As part of this process, Vistry aims to return ~1 billion GBP to shareholders over the next three years, while eliminating net debt. This will likely come in the form of

buybacks, which have already begun. A £1B buyback in context of a market cap that is a bit over £3B would move the needle on its own.

However, the Company has also laid out a plan to grow operating profit to £800M in the intermediate term from £450M in the near term. The Partnerships business can earn a higher return on capital than traditional homebuilding, and is significantly less cyclical, which suggests that Vistry shares are also deserving of a higher multiple going forward. If all goes as planned, Vistry shares have multi-bagger potential over the next few years. Of course, nothing ever goes exactly as planned, but in the case of Vistry, temporary bumps in the road will likely increase the longer-term upside as the Company will be able to repurchase shares more cheaply.

Also of Note:

Avid Bioservices (CDMO) – Avid, our large molecule Contract Drug Manufacturing Organization, was by far our biggest loser in 2023. After several years of investment, the Company completed a capacity expansion program just as early phase biotech spending was curtailed, largely due to higher interest rates. This led the Company to cut guidance, which led to a sell off that caused the Company to be removed from the small cap SP600, which of course led to forced selling by indexers. The market is now fixated on ~$143M of 1.25% convertible debt that will mature in March of 2026. The combination of higher costs tied to increased capacity and reduced revenue is not good in front of a debt maturity.

However, for the first time Avid recently issued an investor presentation that provides more insights into their late phase pipeline, backlog continues to grow, and recent industry comments suggest that early phase spending is rebounding hard.[iv] In the immediate term Avid will need to match increased revenue with stair step increases in OpEx, but in the not-too-distant future massive operating leverage will kick in, allowing as much as 70% of incremental revenue to drop to the EBITDA line.[v] From there, Avid's brand new facilities will ensure that CapEx is minimal, and substantial NOLs will shield taxes leading to high FCF conversion. At maturity with a high commercial mix these cash flows are annuity like and deserving of a high multiple, representing the potential for multi-bagger gains from here.

To be clear, the debt will need to be addressed, and there are a wide range of potential outcomes on how that might happen. In my mind, all of them represent significant upside, although they are not without mark to market risk. If things go very very wrong it is not impossible that the Company will need to raise dilutive equity. At the same time, the Company has proven that they are good operators, and the pipeline is robust, so it is entirely possible that Avid is able to effortlessly replace the convert with traditional bank debt, which could mean avoiding the dilution that would have come with the $21.21 convert, assuming shares do not recover to that level. It is also possible we wind up with something in the middle, such as rolling the convert to a lower strike price. In all cases, the future earnings power is substantial, the trend toward biologic drugs is unstoppable, and Avid's competitive position is strong. Filling capacity is very much a "when" not an "if." The debt situation means that a few years from now the per share cash flow from this filled capacity could be a little higher or a little lower depending on what shape the refinancing takes and if there is dilution attached, but in my mind worrying too much about this is like worrying too much about how 4 people will split 7 large pizzas; in all cases, there is plenty to go around. Insiders seem to agree as there has been insider buying recently.

Hilton Grand Vacations (HGV) – HGV, the Hilton branded time share business, had a year that came with undeniable improvements to normalized earnings power, and undeniable short-term problems. On the problem side, as mentioned previously the Company was forced to cut guidance following the well-publicized wild fires in Hawaii. Additionally, part of HGV's business is tied to financing purchases by new owners, and this is a spread business where the Company borrows at one rate, and then lends at a higher rate. Rising interest rates put pressure on this spread.

On the undeniable improvements to normalized earnings power side, HGV announced they would be acquiring Bluegreen Vacations (BVH), an un-branded player that has partnerships with Bass Pro Shops and NASCAR. I admit I was initially not thrilled with this acquisition as HGV is still integrating the 2021 acquisition of Diamond Resorts, and has only recently returned to their pre-Covid pattern of aggressively repurchasing shares. However, these are scarce assets that must be bought when they are available, the price paid after easily achievable synergies is very reasonable, HGV was NOT the high bidder (BVH preferred to sell at a lower price in order to partner with HGV), and these assets open up HGV's customer acquisition funnel to the lower end of the Hilton Honors loyalty network. Importantly, there is a demonstrated history of branded players being able to realize more revenue out of unbranded assets in the time share industry. Lastly, management has indicated they would continue to repurchase shares.

At this point, I think there are two likely outcomes for HGV stock. In the first scenario, by year end 2024 the market begins to give HGV credit for their normalized earnings power inclusive of BVH synergies, which should be fully realized by year end 2025. At the same time, the market recognizes that this business is more durable than most expect. HGV remained FCF positive through Covid and was able to make a large acquisition, yet trades at a lower multiple now then it did pre-Covid. At the same time, cruise lines were cash furnaces through Covid, and were forced to massively dilute their equity to stay alive. Yet cruise lines now trade at a premium to the multiple they traded at pre-Covid. In fact, Cruise lines trade around ~25x 2025E FCF to equity, while HGV trades at less than 5x my estimate of normalized 2025E FCF to equity.[vi] I don't like to hang my hat on relative valuation, but this discrepancy is massive, especially in context of the continued potential for macro weakness. If the economy slows, cruise lines have a real problem. If the economy slows, HGV's business will be just fine, and they will be able to repurchase shares at lower prices.

If the market recognizes the absurdity of this relative valuation, HGV shares could be up ~150% in 2024. That is clearly a blue sky outcome and should not be taken as a base case, but in context of Royal Caribbean's(RCL) 162% gain in 2023, it should not be entirely dismissed either. To be fair, cruise lines benefit from being in the SP500 and have ~15 sell side analysts, while HGV is not in the SP500 and has 5 analysts, who have not yet updated their estimates to reflect the acquisition of BVH, so perhaps HGV will not aggressively re-rate.

In this scenario, I believe HGV will become an "uber-cannibal" and aggressively return capital to shareholders through buybacks for years to come. The Company's stated goal is to repurchase ~$100M shares of stock per quarter, which equates to about 9% of the company per year at current prices. These situations never look sexy at a moment in time, and taking a long-term view is decidedly out of favor on Wall Street these days, but there are many examples (AZO and NVR come to mind immediately) of companies with relatively boring business models that compounded at 20+% per year over long periods of time by growing a bit every year, and repurchasing stock every year. A (very) low starting valuation means that eventually the market will take note and multiple expansion will follow, likely leading to multi-bag gains with time. HGV's business is such that while they will have good years and bad years, they have

25 years of cohort data that shows that overtime owners reliably increase their spend, which will increase earnings. Further, they are in a strong inventory position at present which represents continued future organic growth, and in this day and age travel is essentially a fundamental human need, right up there with food and shelter. All else equal I would prefer that shares of HGV rapidly re-rate, but I view this investment as a heads we win soon, tails we win more later setup.

Mistakes and Bad Outcomes

Enzo Biochem Inc (ENZ) – As detailed in our 1H'23 letter, my investment in Enzo earlier this year led to a permanent loss of capital. In brief, after a multi-year activist battle, Enzo agreed to sell their clinical labs business to Labcorp (LH) for a price that was more then the current market cap of the Company. Enzo would continue to own another, subscale business that could prove to be quite valuable, and in fact, a recently hired CEO had grown a similar business by 5x previously. I purchased shares before the deal closed under the reasoning that it is no secret that the entire clinical labs industry is being consolidated by Labcorp and Quest Diagnostics (DGX), meaning that these two companies are in frequent competition on deals. I reasoned that Labcorp would not walk away from the deal, because if they did, in every future potential deal Quest would remind the seller that Labcorp cannot be trusted. Shortly after my purchase Enzo was hit by a cyber attack with unknown costs, and Labcorp did in fact substantially reduce their purchase price. I exited the position shortly thereafter.

Vanda Pharmaceuticals Inc (VNDA) – Vanda was introduced anonymously in the Q3'23 letter as a stock that was trading at less than half the cash on its balance sheet, while continuing to generate cash from pharmaceutical assets that had rolled off patent. Generally speaking, it is hard to lose money when buying cash flowing assets at a significant discount to balance sheet cash, but at the same time the big risk is obvious; management may do something stupid with the cash in order to entrench themselves. Shortly after my purchase, the Company announced they had made an acquisition while releasing essentially no details on the acquired company. This lends credence toward the entrenchment risk, and I exited the position.

Administrative Matters: K1s and Annual Audit

The team at Spicer Jeffries is hard at work on our annual audit and tax documents. I expect that you will have K1s well in advance of tax day, as has been the case in the past.

Looking Forward

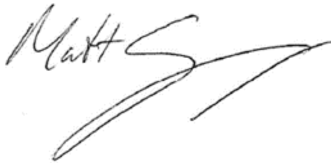
As always, I have no idea what to expect in the near term, and I suspect that you treat anyone who claims to have the answers with suspicion. What I can say is that the headline multiple of the SP500 does not scream cheap. At the same time, according to JP Morgan, absent the top 10 names in the SP500 – many of which trade at nose bleed valuations – the multiple would be 17.1x, which would be just a touch higher

than average. More important for us, according to KKR, U.S. small cap stocks are 4% expensive vs. their 20 year average, while U.S. large cap stocks are 88% expensive vs. their 20 year average.[vii]

It is not clear to me that these stats have any predictive value in the near term, but in the intermediate and longer term, in theory our strategy should pick up a tailwind. Most importantly, the stocks of our individual businesses are well positioned after a year that was characterized by notable improvements to normalized earnings power, often without a related move in stock price. This is of course frustrating, but the path forward is clear. The best strategy is for me to continue to stick to a process that does everything possible to tilt the odds of success in our favor. We will inevitably suffer from bad outcomes and temporary bumps in the road along the way, but over longer periods of time and enough iterations we should be rewarded. History suggests that the discrepancy between price and fundamentals caused by this year's short-term events will correct itself with time, and I would not be surprised to see a rapid re-rating.

Beyond that, it seems as if the U.S. Presidential election this year will come with tremendous uncertainty, which is generally a bad thing for near term price action. At the same time, it seems as if both sides have concluded that the surest path toward victory is to shower the populace with money in one form or another, which presumably would be good for stocks. In either case, the person sitting in the Oval Office will not stop the trend toward biologic drugs, or fix the housing crisis in the U.K., or prevent building owners from maintaining their fire safety systems. Each of our businesses is aided by unique competitive advantages and properly aligned management teams, and each is well positioned to improve their prospects with time regardless of politics. Further, the track record of markets moving higher within a reasonable period of time following elections is 100% historically. I remain excited for the future, and have nearly all of my and my family's wealth positioned to benefit, right along-side yours.

Please let me know if you have any questions,



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[i] Laughing Water Capital refers to Class A interests in Laughing Water Capital, LP, Laughing Water Capital II, LP, and related entities.

[ii] A company that takes on tremendous leverage to grow would be an obvious example.

[iii] sec.gov/Archives/edgar/data/1865631/000121390021031809/ea142270ex99-3_spartacusacq.htm

[iv] See comments from WuXi Pharmaceuticals at the 2024 JPM Health Care Conference

[v] Q3'21 Company conference call

[vi] Cruise line multiples based on sell side consensus provided by Sentieo. HGV multiple is LWC's estimate.

[vii] https://www.kkr.com/insights/outlook