October 19, 2021

Dear Partner,

The performance of the Kinsman Oak Equity Fund was +1.5% for the third quarter of 2021, net of all fees and expenses[1] compared to the benchmarks set forth below.

Performance (%)	Q3 2021	YTD 2021
Kinsman Oak Equity Fund	**1.5**	**8.1**
S&P 500 Index	0.6	15.9
Russell 2000 Index	(4.4)	12.4
S&P / TSX Composite Index	0.2	17.5

COMMENT ON PERFORMANCE

The Fund increased in value by high-single digits year-to-date and has averaged ~70% net invested. Our underlying holdings experienced a relatively uneventful quarter from a fundamental standpoint. Returns were driven entirely by our long book while our short book contributed negligible positive returns. We added and closed a couple smaller positions and made minor adjustments to a few of our position sizes throughout the quarter.

MARKET COMMENTARY

Looking back, it appears speculative fervor peaked in the first quarter and has rolled over since then, although both sentiment and valuations remain elevated, in our view. We continue to monitor the Panic/Euphoria Model published by Citi Research which we referenced in our last quarterly letter (recently renamed the Levkovich Index). Sentiment, as measured by this indicator, remains below its all-time high but is still considered to be deep in euphoric territory (Appendix A).

Almost every popular meme stock and overly promotional SPAC trade far below their 52-week highs. Ark Innovation ETF (ARKK) net fund flows provide a decent barometer for gauging broad speculative appetite. Bloomberg estimates ARKK received net inflows of ~$8.3 billion from January 1st to April 15th of this year and had net outflows of ~$3.0 billion from April 16th to September 30th (Appendix B and C). Again, fund flows are still positive on a year-to-date basis, but fervor appears to be waning.

Inflation has been the topic du jour lately. Yields continue to be the fulcrum driving factor rotations. At the risk of sounding like a broken record, single stock volatility remains elevated for this reason, despite the appearance of a rather smooth ascension to new highs for most indexes. Investors are beginning to turn their attention to what rising costs and component shortages could mean for upcoming earnings and forward guidance. Tailwinds are turning into potential headwinds, especially if the pace of fiscal stimulus slows or central bank liquidity is withdrawn.

[1] Individual performance may vary depending on Class of units held and subscription date.

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INFLATION MORE 'TRANSITORY' THAN EXPECTED

Six months ago, we discussed our belief that secular inflation was premature to conclude based on the available information at the time. Today we find ourselves closely re-examining our thoughts on the subject. We seldom agree with central banks in general, so sharing their view that inflation was transitory felt unusual. Here we are six months later, and inflationary pressures persist with little signs of abatement.

Input cost inflation, component shortages, and labour issues present a real risk to revenue and earnings expectations going forward. Sustained inflation will persist as cost structures continue rising, and logistical nightmares wreak havoc on global supply chains. The labour market remains a complete mess. It is difficult to envision how these issues will meaningfully alleviate anytime soon. Rising inflation combined with lower economic growth suggests potential stagflation.

We continue to believe longer-term structural disinflationary pressures will eventually reassert themselves. Low economic growth, hyper-financialization of the economy, excessive debt levels, financial repression, gargantuan unfunded liabilities, and severe demographic challenges have all intensified. But the path from *today* to *long-term*, or the duration of time between those two points, is much less clear.

Real **Real Interest Rates Deeply Negative**

Official CPI metrics for September were +5.4% y/y while the yield on the U.S. 10 year was +1.57%, meaning real interest rates are -3.83%. People can endlessly debate the exact accuracy of CPI metrics, but it is clear, given substitution effects and hedonic adjustments, official headline numbers are vastly understated. Further obfuscation comes from the OER (Owner's Equivalent Rent) component of these calculations which, in our view, has become farcical and in no way reflects reality.

As such, we believe 're-normalizing' the data to better reflect actual rising price levels would result in higher true CPI metrics, although it's impossible to quantify by precisely how much. The same way Warren Buffett doesn't need to know the exact weight of a 350-pound man to know he's fat, we don't need to know exactly how much higher true inflation is to know that *real* real rates are more negative than meets the eye. At current yields, U.S. Treasuries are essentially trading sardines used for collateral purposes.

Severe Supply Chains Issues Are Getting Worse

Supply chain issues pose a material risk to revenue, earnings, and forward guidance expectations. Describing these issues as unprecedented feels like a gross understatement. Supply/demand dynamics have arguably never experienced such a severe and abrupt dislocation. The pandemic put immediate constraints on the supply of goods and services while a flood of direct fiscal stimulus increased the demand for said goods and services. Besides inflation, the obvious consequences from this staggering mismatch were product shortages and dysfunctional supply chains.

Admittedly, we underestimated the amount of time it would take for supply chains to renormalize. It's important to remember what these complex networks looked like pre-pandemic. They were designed in a way that maximized efficiency at the expense of robustness. There was no slack built into these systems, making them extremely fragile to external shocks. A grain of sand entering a fine-tuned engine could grind it to a halt. This pandemic was basically ripping the engine out of the machine entirely and tossing it into the desert. As if that wasn't bad enough, the pandemic caused changes in global consumption patterns as well. Repurposing these complex networks to accommodate new preferences requires time and capital.

Sourcing metal shipping containers is difficult and, even if your business can pay nosebleed prices to find some, port availability becomes your next major hurdle. Anchoring a large ship in the ocean to wait for empty loading dock space is expensive. If those ships are transporting critical components, the delay could cause serious bottlenecks in a much larger manufacturing process. For instance, even Apple recently announced production cuts due to chip shortages. On one hand, we believe the logistical nightmares are temporary. On the other, we wonder if implementing a permanent solution, such as increased redundancy and capacity, will result in higher structural logistics costs going forward.

Inflation Rolls Downhill

Input cost inflation takes time to flow from those at the beginning of the supply chain (Point A) to the end consumer (Point Z). Generally, intermediaries between Point A and Point Z are inclined to absorb initial price hikes from their supplies, keep prices flat for their own customers, and accept temporary margin degradation to drive improved retention. But, as time passes, these intermediaries will begin to pass more of those incremental costs down the chain to their customers, who then pass it along to their own customers, and so forth. Eventually, the end consumer is paying higher prices, but there can be a lengthy delay from when those at the beginning of the supply chain hike prices and those at the end experience them.

We highly recommend reading the Lamb Weston (LW) and Bed Bath and Beyond (BBBY) earnings call transcripts to get a deeper understanding of how broad based these inflationary pressures are. Lamb Weston, specifically, mentions how their input costs have skyrocketed but the company has only passed a portion of that increase onto their end customers. As such, the company plans to implement a series of price hikes over the next several quarters to compensate for that. Clearly, cost inflation is rolling downhill, albeit slowly. This suggests end consumer inflation will continue to persist over the intermediate time frame as these pricing pressures roll all the way down hill.

Further, rising prices do not typically occur in a vacuum. They are generally accompanied by longer lead times, widespread product unavailability, and empty shelves. It's worth noting there are no upward adjustments to CPI figures for longer lead times or product availability either. We wonder if there may be a possible inventory overhang once supply chain issues dissipate. It is possible businesses are over-ordering products from their suppliers, assuming they will only get a small percentage of whatever they ask for. Empty inventory channels today could potentially precede bloated inventory channels down the road.

Labour Market Oddities

Labour market conditions have gone from unusual to completely bizarre. Job openings in the U.S. reportedly fell from a record of 10.9 million to 10.4 million and the unemployment rate is falling. At the same time, it's also been reported that a record 4.3 million workers recently quit their jobs (Appendix D). Many believe labour shortages are driving supply chain issues but none of the explanations for why these shortages exist in the first place seem to adequately justify the magnitude of how bad these problems are.

Companies we follow have made numerous references on recent earnings calls about higher wages weighing on cost structures and cite major employee retention difficulties. Whatever the underlying causes may be, it's obvious the clearing rate of pay for most jobs keeps climbing. The word unprecedented is thrown around way too often lately but these labour market oddities are truly confounding. Widespread labour shortages combined with worsening supply chain issues are deep economic problems that cannot be solved overnight. Both of which will likely exacerbate broad inflationary pressures for quite some time.

PORTFOLIO UPDATE

As of the end of the third quarter, the Fund held sixteen long positions with net exposure at ~70% invested (~85% long and ~15% short). The breakdown of the Fund's sixteen long positions are as follows: fourteen U.S. listed and two Canadian listed. The Fund's short positions are all U.S. listed. The Fund does not have any exposure to biotech, financials, energy, or metals & mining.

LONG POSITIONS

There was some turnover in our long book this quarter. We exited a couple of our smaller positions to make room for newer opportunities we feel possess a better risk-return profile. Our core holdings remain largely the same, although we reduced our position size in some stocks, most notably Tempur Sealy which is discussed in more detail below.

RCI Hospitality Holdings (RICK) – *New Long Position*

RCI Hospitality Holdings (RICK) is a high margin free cash flow machine with strong underlying business momentum. Our investment thesis is as follows: 1) Multiple re-rating candidate; 2) Long runway to roll up a highly fragmented industry; 3) Upside optionality from an emerging restaurant concept. We initiated a position at an ~11% FCF yield which we felt was a compelling valuation.

RICK is comprised of two business segments. Segment 1: The core business is a portfolio of mature cash-flowing adult nightclubs and Segment 2: An emerging restaurant concept called Bombshells. The management team focuses on capital allocation between these two segments and will repurchase shares depending on where ROI is highest. Growth in the adult nightclub business is primarily via acquisition whereas Bombshells is organic. Sales mix by segment and revenue type is broken down in Appendix E.

Nightclub Segment

RICK has spent the past decade rolling up the highly fragmented adult nightclub market and growth in this segment primarily comes from M&A. As of right now the company owns 38 nightclubs (~80% were acquired) and has agreements to purchase another 12 in two separate transactions. RICK targets annual cash-on-cash returns of at least 25-33% for all nightclub M&A transactions.

The adult nightclub business has more barriers to entry than one might think. Municipalities issue licenses to operate these kinds of establishments and, as you would expect, most local politicians are not eager to have adult nightclubs springing up all over town by granting new licenses. These licenses are also tied to the underlying property on which they are located, so an owner can't close their doors in one area and choose to move the operation elsewhere.

This is also why RICK owns most of their properties and why they survived last year's lockdowns without jeopardizing the balance sheet. Total debt outstanding actually stayed flat throughout lockdowns. RICK didn't issue equity either. In fact, the company slightly reduced their share count over this period.

RICK's nightclub segment has incredible margins (86% gross margins and 44% GAAP operating margins in Q3 2021). The maintenance capex associated with this segment is minimal. Needless to say, it's a cash-flow machine (Appendix F).

Bombshells Segment

RICK owns 10 Bombshells locations at the time of writing, and all of them are operating at 100% capacity as restrictions have been lifted. Typically speaking, each location is about 10k sq. ft. (8k sq. ft. inside + 2k sq. ft. outside). Some properties are owned, and others are leased. Hours of operation are generally 11 a.m. to 2 a.m.

Unit economics are compelling. Each location averages $5 million in sales with 20% EBITDA margins. The Bombshells segment today annualizes ~$50 million in sales and ~$10 million in EBITDA. Each new location costs between $1 million and $3 million depending on whether the underlying real estate is owned or leased, and management targets annual cash-on-cash returns between 25-33%. The challenge is finding the right locations, so the company doesn't have to sacrifice ROI for the sake of growth.

This is partly why RICK has only added two new locations in the past two years. On the surface it may seem like a low-growth segment, but we believe there is a lot of upside optionality here. The company shares our sentiment and believes they can double the location count by 2023.

Improving the Bombshells concept to maximize the value proposition and unit economics took a certain amount of trial and error which is also partly why growth has yet to inflect. We believe the management team has recently figured out the algorithm and growth will pick up going forward. Evidence of this is the rising interest from potential franchisees. Outside (unbiased) business owners and entrepreneurs are becoming increasingly interested in opening their own Bombshells franchise which, in our view, validates the concept's value proposition and economics.

Again, the challenge will be finding the right locations for the initial franchisees. RICK could conceivably build out a successful franchise program for Bombshells over the next 3-7 years which gives the stock additional potential upside. Even if this doesn't materialize, adding another 10 company-owned locations with 25-33% cash-on-cash returns is an effective way to compound FCF.

Transformative Nightclub Acquisition

RICK recently made their largest acquisition to date, buying 11 locations for $88 million in total (Clubs $57M + Intellectual Property $13M + Real Estate $18M). The clubs generated approximately $40 million in revenue and $14 million in adjusted EBITDA in CY19. Assuming RICK paid fair value for the underlying real estate, the company purchased the portfolio of nightclubs for 5x EBITDA.

An accretive acquisition of this size is needle-moving for a company like RICK. We expect the growth rate at the acquired nightclubs to be higher than average after a six-month integration period. It's our understanding that the seller had been preoccupied in recent years with personal matters and the nightclubs in general were underearning.

The acquisition will still be a great deal even if growth at the new clubs does not outpace the existing clubs. Purchasing the portfolio for 5x EBITDA suggests a high ROI / FCF yield on the investment even if EBITDA remains flat. RICK can extract free cash flow and re-deploy the proceeds into further M&A, the Bombshells segment or share buybacks.

Free Cash Flow Profile & Capital Allocation Strategy

RICK is a FCF story so gauging roughly how much revenue flows all the way down to the bottom line is important. We estimate ~20% FCF margins as a percentage of total revenue. This approximation is based on a combination of pre-Covid and post-Covid performance (Appendix G).

FCF margins in FY19 were 18.4% and the only reported quarter since re-opening the company generated a 22.5% FCF margin. It's difficult to know how much of that margin expansion is sustainable given various puts and takes, but we feel the average is a reasonable estimation.

We also believe RICK's management team has demonstrated competency compounding capital for shareholders. The company details their capital allocation strategy in Appendix H, and targets annual FCF/share growth between 10-15% through a combination of nightclub M&A, Bombshells expansion, and share repurchases.

Valuation & Assumptions

We believe RICK should be valued on a multiple of FCF given the high margin profile of the business, the relatively predictable nature of those cash flows, and minimal ongoing capex requirements. As such, the stock price will be a function of three factors: 1) Revenues; 2) FCF margins; and 3) The multiple ascribed to those cash flows.

We estimate RICK's base business can grow top line at MSD over the next few years and maintain 22% FCF margins. These estimates may prove too aggressive, especially with the broad labour market issues and input cost inflation previously discussed, but the company entered peak season (October – May) with strong underlying business momentum. We wouldn't be surprised if RICK accelerated the pace of tuck-in acquisitions either.

From a fundamental standpoint, the business should continue to reap some scale benefits as they roll more nightclubs into their portfolio. Expanding new Bombshells locations will also help drive revenue growth and adding franchisees will enhance the consolidated margin profile. Other positive catalysts like debt re-financings will be a tailwind.

We feel the business is worth at least 15x FCFE (6.7% yield) given the relatively stable nightclub revenue stream, high margin profile, above average barriers to entry and a long runway for acquisitive growth. Upside optionality from the Bombshells segment is worth something too.

Risks to Our Thesis

The two most obvious investment risks (other than execution risk) are general legal/regulatory risks pertaining to the adult nightclub industry and broad-based inflationary pressures. RICK appears to operate their portfolio of clubs far better than industry average and has developed extensive due diligence experience with acquisition targets, which mitigates this risk somewhat but not entirely.

Inflationary pressures will likely impact RICK's business. The company has more exposure to rising labour costs and food cost inflation than average. But the degree to which these factors will disrupt operations, how much can be mitigated/offset elsewhere, or for how long it will persist is more difficult to gauge. Other risks include the potential of a value trap, choppy trading patterns, and integration risk.

Tempur Sealy International (TPX) – *Trimmed Long Position*

We reduced the size of our TPX position this quarter. The overall industry benefitted from two major tailwinds over the past year and half since we've owned it. First, consumers reallocated household spending away from travel & leisure and redirected those dollars into home improvements and furniture. Second, enormous direct fiscal stimulus flooded into the system and essentially subsidized consumption. TPX remains cheap based on forward earnings, but those tailwinds will ultimately become headwinds. The boon in mattress sales likely pulled forward enough demand to create material 'pent-down demand'.

Consumers will reallocate household spending back to travel & leisure activities and direct fiscal stimulus is subsiding. The replacement cycle for mattresses hasn't changed either. In fact, with the improved quality of mattresses on the market, one could argue the products last longer and need to be replaced even less often than before. TPX has done a phenomenal job relative to other competitors in the industry and continues to take significant market share. Sleep Number (SNBR), Purple Innovation (PRPL), and Casper (CSPR) are 42%, 50%, and 65% below 52-week highs, respectively.

SHORT POSITIONS

Our short book was primarily comprised of bubble stocks and broken growth stories at the end of the quarter. We have a comprehensive list of other stocks on our radar. Broad themes these opportunities generally fall into are pent-up demand becomes pent-down demand, a super-cyclical industry we expect to undergo a multi-year period of earnings compression and negative revenue growth, value destructive major acquisitions (including SPAC transactions), and certain re-opening stocks trading at obscene valuations.

We have been unusually patient building our short book thus far, partly due to our patience deploying capital on the long side and partly because the environment was inhospitable to do so effectively. But now we believe there are vulnerable pockets within the market, and we'll aim to take advantage of that. Volatility remains elevated so we intend to do so with tighter risk controls.

On top of that, we'll try to time our entries closer to potential catalysts, though easier said than done. This approach will likely cause us to miss good opportunities, but we feel our watch list for potential shorts is extensive enough that even if we don't swing at every meatball floating across home plate, we will make up for it with other ideas. Said differently, we would rather incur errors of omission than commission.

LOOKING AHEAD

Investor sentiment is off peaks but remains way higher than historical averages. Valuations are considered extreme by every conceivable metric and economic growth is decelerating. Economists are beginning to cut GDP forecasts and nominal yields continue rising. Inflationary pressures exacerbated by logistical nightmares and labour market challenges could potentially threaten earnings. We continue to see opportunity on both the long and short sides of the portfolio, but will exercise more caution and tighter risk controls as we attempt to generate returns.

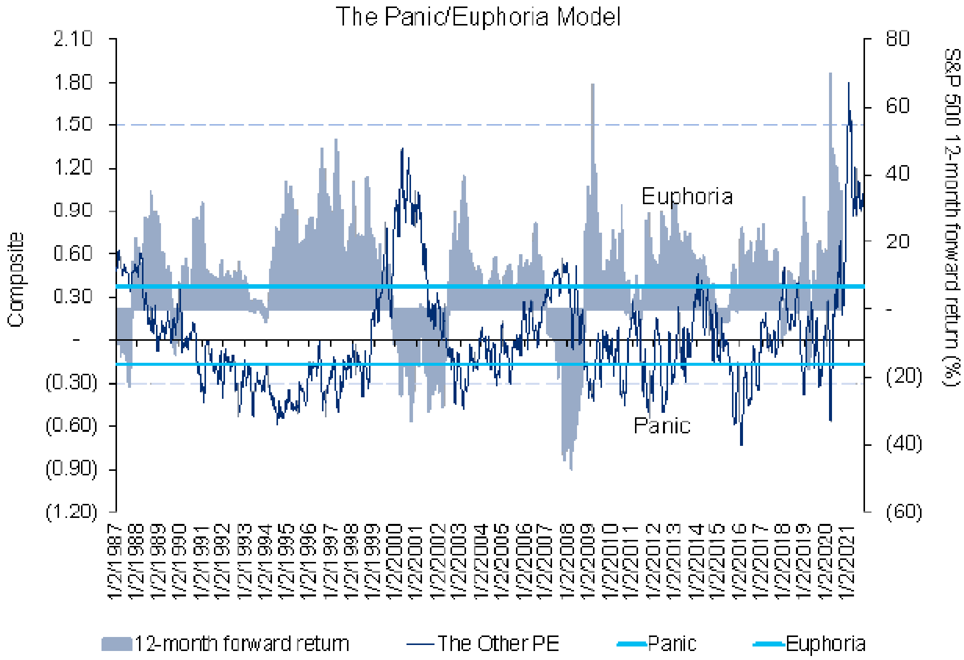
Sincerely,

A. Agostino

Alexander Agostino

APPENDIX

Appendix A:



Source: Citi Research – U.S. Equity Strategy, Haver Analytics, Pinnacle Data

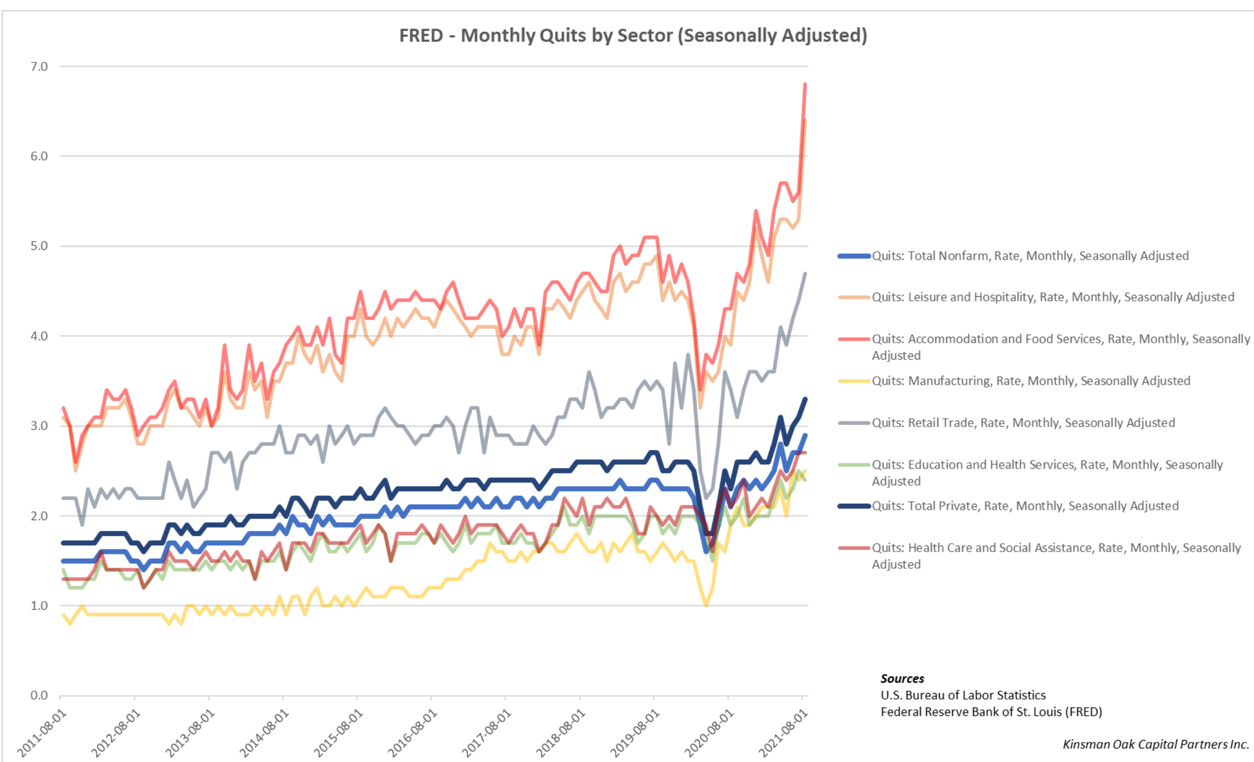
Appendix B:

Source: Bloomberg

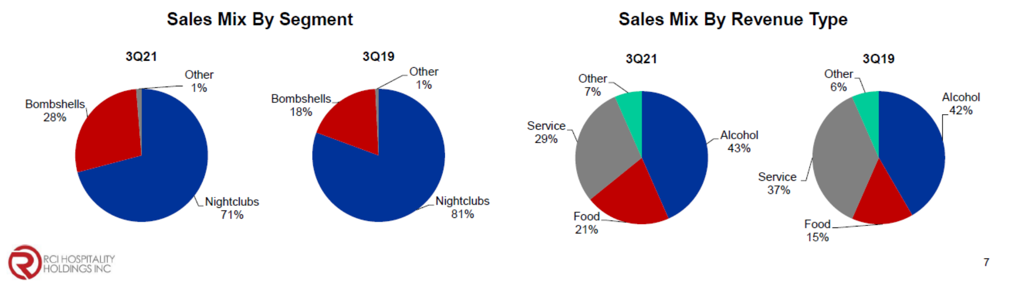
Appendix C:

Source: Bloomberg

Appendix D:

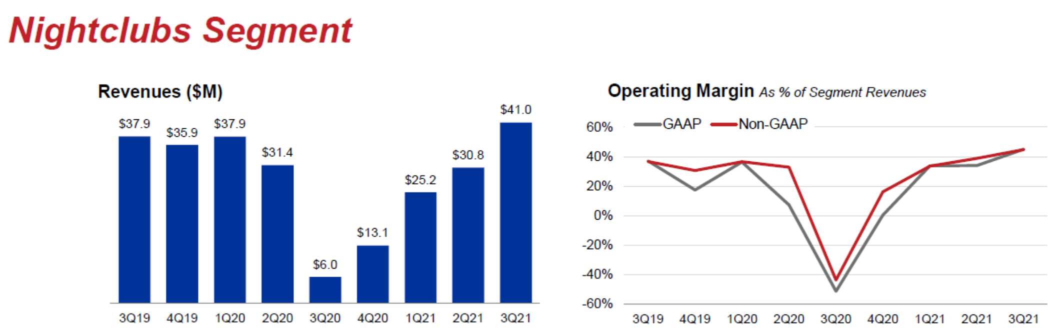


Appendix E:



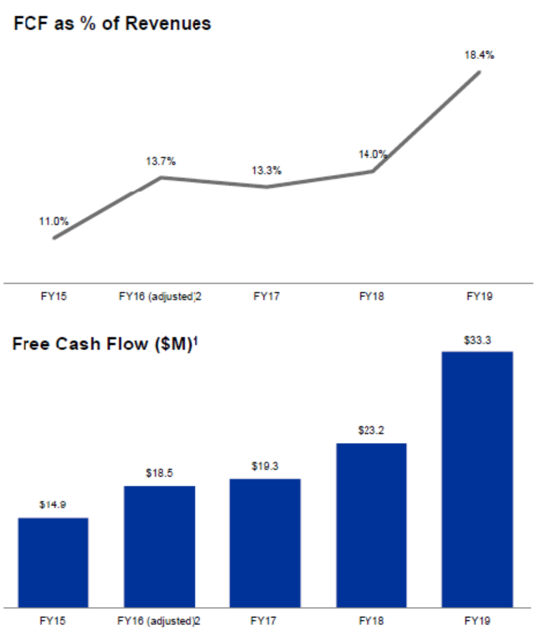
Source: RICK 3Q21 Earnings Call Presentation – August 5, 2021

Appendix F:



Source: RICK 3Q21 Earnings Call Presentation – August 5, 2021

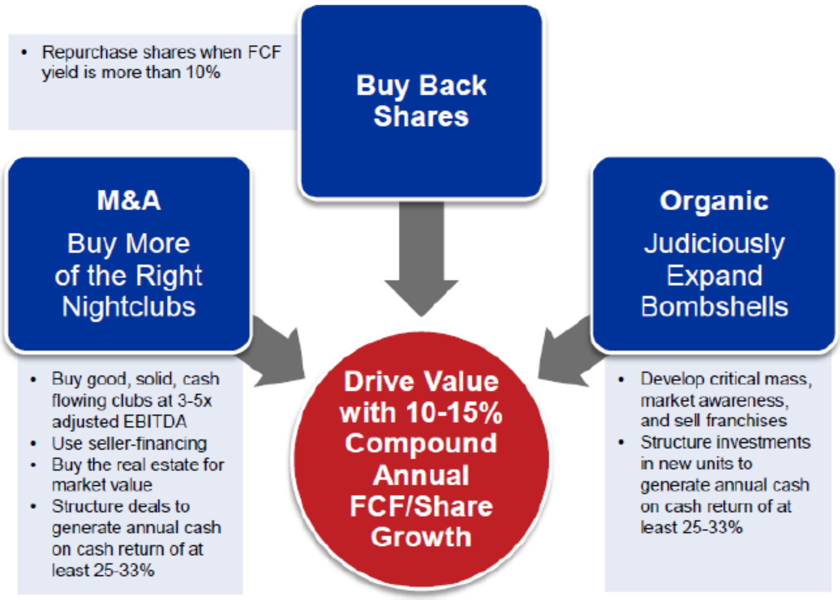
Appendix G:



($ in millions, except EPS)	Total	
	3Q21	3Q19
Revenue		
Consolidated	**$57.9**	$47.0
Nightclubs	**$41.0**	$37.9
Bombshells	**$16.1**	$8.8
Income (loss) from Operations		
Consolidated	**$18.5**	$10.0
Nightclubs	**$18.4**	$14.0
Bombshells	$4.4	$0.7
Operating Margin		
Consolidated	32.0%	21.2%
Nightclubs	44.7%	37.0%
Bombshells	27.4%	7.8%
Units at Period End		
Nightclubs	36	38
Bombshells	10	8
GAAP EPS	$1.37	$0.59
Non-GAAP EPS	**$1.36**	$0.59
Net Cash Provided by Operating Activities	**$15.0**	$7.4
Free Cash Flow	**$13.0**	$6.5

Source: RICK 3Q21 Earnings Call Presentation – August 5, 2021 & RICK Investor Presentation – November 19, 2020

Appendix H:



Source: RICK 3Q21 Earnings Call Presentation – August 5, 2021

LEGAL INFORMATION AND DISCLOSURES