

## Q1 2023 Alta Fox Opportunities Fund, LP Quarterly Letter

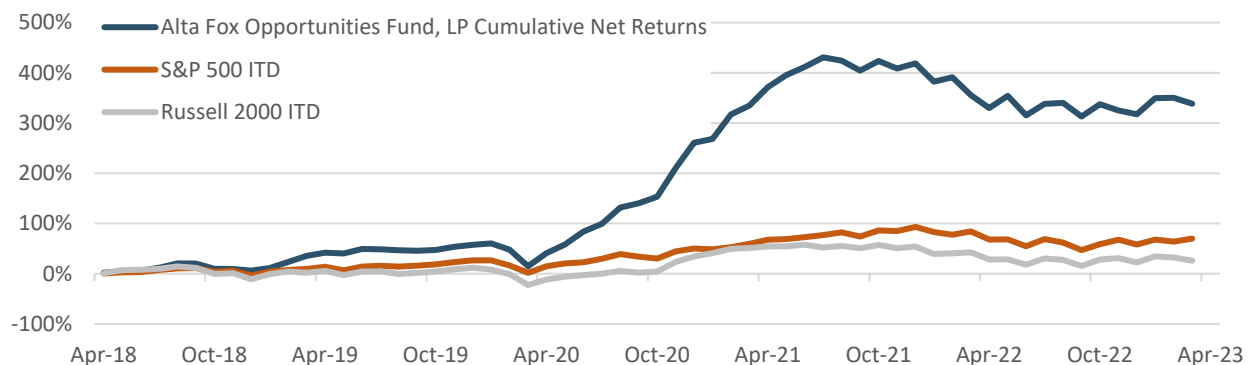
May 2023

Limited Partners,

In Q1 2023, the Alta Fox Opportunities Fund (“the Fund”) produced a gross return of 5.56% and a net return of 5.04%. The Fund’s average net exposure during the quarter was 57%. Since inception in April 2018, the Fund has produced a gross return of 545.95% and a net return of 338.52% compared to the S&P 500’s return of 69.95% and the Russell 2000’s return of 25.87%.

Alta Fox Opportunities Fund, LP <sup>1</sup>			Relevant Index Returns <sup>2</sup>	
	Gross Return	Net Return	S&P 500 (SPY)	Russell 2000 (IWM)
Q1 2023	5.56%	5.04%	7.50%	2.74%
YTD	5.56%	5.04%	7.50%	2.74%
Since Inception	545.95%	338.52%	69.95%	25.87%
Annualized	45.22%	34.40%	11.19%	4.71%

Alta Fox Opportunities Fund, LP: Cumulative ITD Net Performance<sup>1,2</sup>

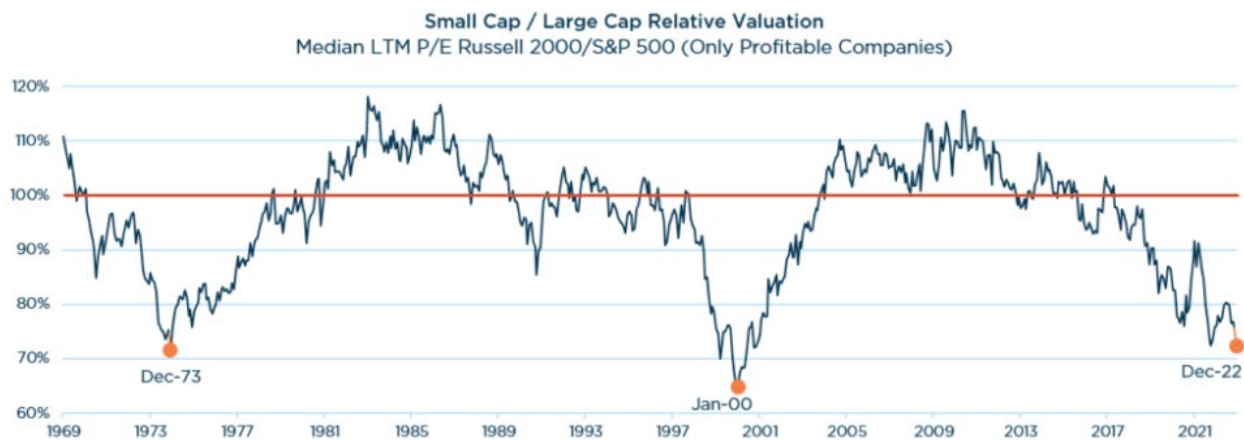


1. Past performance is not indicative of future results. The Alta Fox Net Return figures reflect the hypothetical USD performance of an LP in the Alta Fox Opportunities Fund that has participated in all Special and Private investments, and are net of all Fund related expenses, a 2% management fee, and 20% performance fee. Net returns will vary by share class. 2023 returns are unaudited but have been verified by the Fund’s administrator. Please see the endnotes on the final page for important information with respect to the calculation of returns and indices referenced.
2. Source: Bloomberg - S&P TR (SPXT Index) and Russell 2000 (RU20INTR Index). Reference to an index does not imply that the funds will achieve returns, volatility, or other results similar to the index. Please see the endnotes on the final page for important information with respect to the calculation of returns and indices referenced.

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

## **Market Commentary**

Many research studies have concluded that small cap stocks have historically outperformed large-cap peers over a long time period.<sup>1</sup> However, this trend has not continued in the last two decades, since the inception of Alta Fox, or year to date. Since the inception of Alta Fox, the S&P 500 has produced 11.2% annualized returns compared to the Russell 2000 at 4.7% annualized. The underperformance of small-cap stocks (using the Russell 2000 as a proxy) has continued year-to-date. Small-cap stocks are now approaching historically cheap levels relative to large-caps, as exhibited in the below chart from Furey Research.<sup>2</sup>



While there is inherently significant “noise” in comparing indices against each other, Alta Fox is constructive on the small-cap space and believes it should prove a good hunting ground for alpha, particularly given the current valuation disparity.

Moreover, we are skeptical about some of the large and best known “compounders.” When stocks continue to outperform year after year, powering the market-cap weighted indices higher, investors can become complacent to the importance of valuation and risks. Alta Fox tries to study most of the greatest businesses in the world. We admire their business models, study the readthrough impacts for other businesses, and when we determine valuation is attractive, we invest in them. Today, however, we are less excited about this universe of “generals” than at any point over the last five years. Many of these great businesses are trading at historically expensive valuation multiples despite likely decelerating fundamentals. In our view, this is a recipe for disappointing future returns. This view does not necessarily imply a major drawdown as another possible path could be muted returns for a long period of time while these companies “grow into” their elevated valuation levels. The legendary Stanley Druckenmiller recently hinted at this type of outcome as he remarked that he would not be surprised if major indices were not much higher ten years from now than they are today.<sup>3</sup>

<sup>1</sup> [https://rmbcapital.com/news-and-insights/why-small-cap-now#:~:text=It%20has%20long%20been%20an,200bps\)%%20on%20an%20annualized%20basis.](https://rmbcapital.com/news-and-insights/why-small-cap-now#:~:text=It%20has%20long%20been%20an,200bps)%%20on%20an%20annualized%20basis.)

<sup>2</sup> Source: The London Company’s *A Time for Quality in Small Caps* article dated 2/27/23

<sup>3</sup> <https://awealthofcommonsense.com/2022/10/could-we-see-another-lost-decade-in-the-u-s-stock-market/>

## **Alta Fox Market Positioning**

Alta Fox is currently:

- Skeptical of large-cap valuations and pessimistic about future returns from some of the most popular stocks in the market today.
- Seeing opportunity in small-cap equities, particularly internationally.
- Believes the ability to “create your own catalyst” via governance improvements, strategy changes, activism, etc. will prove a valuable tool in the coming years. This is particularly true for unlocking the hidden value in some small caps that are trading at low valuations but lack a catalyst.
- Generally positive on the special-situation environment and catalyst-driven investing, particularly if markets enter a period of muted index-level returns.

## **Announcing Our Largest Position: Daktronics (DAKT)**

Daktronics is emblematic of the creative and flexible research process at Alta Fox. Despite being public for nearly 30 years, Daktronics is off the radar of most institutional investors given there is no sellside equity research coverage, only two conference calls per year and minimal outbound investor relations efforts. While we had been aware of the company for some time, we began our deep dive in earnest into the company and industry in the Summer of 2022. Through conversations with numerous industry experts and a trip to the company’s headquarters in Brookings, South Dakota, we developed a high conviction thesis on the stock. The company is a manufacturer of electronic scoreboards and large screen video displays across several growing end markets, many of which Daktronics is the market share leader. Daktronics was founded in a garage in 1968, delivered its first scoreboard in 1971 and just five years later its scoreboard was used in the 1976 Olympics. The consistent narrative that emerged from our research was that Daktronics has a long history ([recently celebrated its 50<sup>th</sup> anniversary](#)) of manufacturing the best products in the market, and provides a quality experience for its customers.

Due to severe covid-related supply chain disruptions, Daktronics’ financial performance deteriorated meaningfully over the last several years. The company was forced to pay significant premiums for components (in some cases more than 10x pre-covid prices<sup>4</sup>) and manufacturing operations were frequently disrupted due to outright component shortages and labor availability. Ill-timed growth capital expenditures and incremental investment in working capital combined with the covid-related margin pressures wreaked havoc on the company’s financial statements. The challenges of the last few years stressed the company’s liquidity, culminating in December when Daktronics’ auditor expressed doubt over the company’s ability to continue as a going concern.

The market responded violently, sending Daktronics’ stock down nearly 50% over two days. We believed, however, that the challenges were temporary, demand remained very strong (backlog was, and continues to be, near all-time highs), liquidity would improve over the coming quarters, and the earnings power of the business would soon inflect higher as price increases start flowing through the backlog. Alta Fox took advantage of the weakness, becoming the largest equity holder with a ~6% stake in the company while the stock was at multi-decade lows.

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<sup>4</sup> <https://www.sec.gov/Archives/edgar/data/915779/000091577923000013/projectcougarinvestmentp.htm>

Alta Fox began to engage with both the management team and the Board of Directors to collaborate on solutions to solve its liquidity issues. The team had numerous conversations with the Board, including making a formal presentation to provide the company with an attractive financing solution. After months of negotiations, we are pleased to share that Alta Fox invested \$25 million into a four-year convertible note paying a 9% coupon and being convertible into Daktronics stock at \$6.31 per share. We believe this investment is highly attractive in this market environment, and we suspect that just the coupon portion of the note is likely to beat the S&P 500 over the duration of the note. Moreover, we see a reasonable path forward for the stock price to be multiples higher than current levels.

At today's stock price, we believe Daktronics is trading at ~5x run-rate EBITDA and a double-digit free cash flow yield, a cheap valuation for a growing industry leader with healthy demand trends and a sizable backlog. Furthermore, the valuation is even cheaper when giving credit for the normalization of excess working capital, which is likely to convert to cash over the next 12 months. While margins have been depressed navigating the covid challenges, we believe the company can achieve double digit margins at their current scale. Assuming low single-digit revenue growth and only high single digit EBITDA margins, we believe the stock could be worth ~\$15/share in the next few years. We believe there are reasonable scenarios in which our revenue and margin forecasts could prove conservative, as there are meaningful secular tailwinds in their end markets. The company's most recent quarterly performance provided early validation to our thesis, as the company reported double digit revenue growth and an adjusted EBITDA margin of 9.2% (when adding back non-recurring advisory fees). We look forward to collaborating with the management team and Board to unlock additional shareholder value in a business with a strong legacy and significant potential.

### **Business Updates**

Alta Fox recently hosted a webinar in which we reflected on the first five years of Alta Fox, discussed the enhancements we have made to our team and research process over time, and communicated our vision to deliver strong results over the next five years. Current LPs that did not get a chance to view the webinar can email [IR@altafoxcapital.com](mailto:IR@altafoxcapital.com) for a replay.

After being closed for nearly two years, Alta Fox is doing a limited fund reopening to take advantage of the current market environment. If you are interested in participating in this reopening, please reach out to our team.

### **Conclusion**

We are humbled that you have elected to invest a portion of your assets with Alta Fox. We continue to strive to improve all aspects of our research and operational processes in our pursuit of building a world-class investment firm.

Sincerely,



Connor Haley

## APPENDIX: HISTORICAL PERFORMANCE FIGURES

	Alta Fox Gross Return <sup>1</sup>	Alta Fox Net Return <sup>2</sup>	Alta Fox Net Exposure (Avg)
<b>Q2-2018</b>	7.82%	5.85%	79.31%
<b>Q3-2018</b>	17.12%	13.46%	85.44%
<b>Q4-2018</b>	-13.57%	-11.72%	77.23%
<b>2018</b>	9.14%	6.02%	80.66%
<b>Q1-2019</b>	35.41%	27.87%	83.00%
<b>Q2-2019</b>	12.39%	10.01%	83.45%
<b>Q3-2019</b>	-2.20%	-2.32%	79.07%
<b>Q4-2019</b>	9.96%	8.07%	77.86%
<b>2019</b>	63.65%	48.50%	80.84%
<b>Q1-2020</b>	-26.77%	-27.19%	75.12%
<b>Q2-2020</b>	66.65%	60.31%	75.17%
<b>Q3-2020</b>	37.37%	30.68%	85.35%
<b>Q4-2020</b>	58.32%	50.14%	85.86%
<b>2020</b>	165.41%	129.03%	80.37%
<b>Q1-2021</b>	26.24%	20.56%	93.70%
<b>Q2-2021</b>	21.75%	17.70%	83.75%
<b>Q3-2021</b>	-0.91%	-1.43%	75.58%
<b>Q4-2021</b>	3.81%	2.82%	76.48%
<b>2021</b>	58.11%	43.82%	82.38%
<b>Q1-2022</b>	-11.71%	-12.13%	79.83%
<b>Q2-2022</b>	-8.46%	-8.89%	73.18%
<b>Q3-2022</b>	0.11%	-0.55%	54.23%
<b>Q4-2022</b>	0.92%	1.10%	58.97%
<b>2022</b>	-18.35%	-19.50%	66.55%
<b>Q1-2023</b>	5.56%	5.04%	56.55%

1. The Alta Fox Opportunities Fund's Gross Return ("Alta Fox Gross Return") reflects the USD investment performance of a share class subject to all Fund related expenses but are gross of any management fee and performance fee. 2023 returns are unaudited but have been verified by the Fund's administrator. Past performance is not indicative of future results. Actual returns may differ from the returns presented. References to net exposure and attribution data are internally calculated estimates and could be subject to errors.
2. The Alta Fox Opportunities Fund's Net Return figures ("Alta Fox Net Return") reflect the hypothetical USD investment performance of an LP in the Alta Fox Opportunities Fund that has participated in all Special and Private investments, and are net of all Fund related expenses, a 2% management fee, and 20% performance fee. Net returns will vary by share class. 2023 returns are unaudited but have been verified by the Fund's administrator. Each partner will receive individual statements showing returns from the Partnerships' administrator.

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The S&P 500 and Russell 2000 are U.S. equity indices. The S&P 500 Index is one of the most commonly used benchmarks for the overall U.S. stock market, and it tracks the average performance of 500 widely held stocks including industrial, transportation, financial, and utility stocks. The composition of the S&P 500 is flexible and the number of issues in each sector varies over time. Since the Fund invests across a wide universe of companies and stocks, we provide the S&P 500’s returns as a measure for investors to compare the Fund’s returns to broader market performance. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. Since Alta Fox’s research process typically leads us to opportunities in the small-cap space, we provide the Russell 2000’s returns as a measure for investors to compare the Fund’s returns to broader small-cap performance. These indices’ returns are included for informational and comparative purposes only and may not be representative of the type of investments made by the Fund. Reference to an index does not imply that the Fund will achieve returns, volatility, or other results similar to the index. The Fund’s portfolios are less diversified than these indices. These indices’ returns are total returns which include dividends and do not reflect the deduction of any fees or expenses which would reduce returns.

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