Q1-2023 Letter

Dear Partners, **April 13th, 2023**

I am pleased to inform you that March 31st signified the conclusion of Atai Capital's first-ever quarter. Before I continue, I want to express my sincere gratitude to those who have entrusted me with a portion of their wealth, despite my lack of a verifiable track record. Furthermore, I am excited to introduce you to some of our portfolio companies later in this letter. However, let us first review our performance, explore the reasons behind Atai Capital's inception, and provide some portfolio commentary.

Atai Capital returned 4.39% in the first quarter net of all fees, compared to a 7.50% total return for the S&P500, and a 2.70% total return for the Russel 2000. While our initial results might leave something to be desired, it's important to remember that returns over such a short period can usually be chopped up to noise and shouldn't be given much weight. Instead, we believe a better judge of short-term performance is how our individual portfolio companies are performing at the business level and if we believe their intrinsic values to be increasing. At present, we believe most of our portfolio companies are performing exceedingly well in this regard.

Why I Started Atai Capital:

While our founder's letter provided an overview of the firm, how we're different, some of our advantages, and why we do the things we do, it did not touch on my personal motivations for starting Atai. Prior to launching this venture, I was arguably on track to having a successful career in public equities. However, while working at a large firm, I began to see the long-term trajectory of my career and realized that I wanted to reach my ultimate goal more quickly, so I decided to derail that career in the pursuit of reaching this end goal faster – starting my own firm.

There were various other reasons why I decided to start Atai Capital as well, one of which was my firm belief in following a specific investment philosophy known as value investing. While there are different acceptable approaches within this philosophy, I knew it would prove challenging to find someone who shared similar principles to my own. Value investing can be compared to religion in this regard, and just like with any religion, it has very few true disciples and many false prophets. Therefore, I soon realized that my only options were to sit unemployed in hopes of finding a job under someone whom I respected (that may never present itself), or I could start my own firm, which would enable me to adhere to my investment philosophy without compromise.

Additionally, I came to the realization that life is short and fleeting. No matter how much wealth I accumulate, it won't afford me any additional time. Relocating from Fort Worth to a small town in Florida (for the role mentioned above), where the average resident was over twice my age, made me appreciate that no sum of money could compensate for the loss of family/friends/social life that came with the move. I desire to enjoy both my time at work and outside of work, and running my own business allows me to achieve that. It also enables me to uphold my ethical standards by conducting business in a way that I consider to be transparent and just for clients.

So why am I telling you all this? I believe Incentives and transparency to be important, especially in this business. For me, creating an asset-gathering machine is not the goal. I have other incentives beyond maximizing my own profits, and it is my belief that to succeed in today's market, with all the algorithms, free and easy access to information, and now AI apparently (Those who haven't messed around with Chat-GPT or Google's-Bard should), often requires a focus on smaller and less efficient corners of the market. As I highlighted in our founder's letter, one of our advantages centers around the ability to invest in small caps (sometimes very illiquid ones), and if we want to retain this advantage, we'll eventually have to limit our assets under management. While many managers may balk at this idea because it means less money for themselves, we believe capping our AUM is essential to preserving performance. Therefore, when size becomes a hindrance to our investors, we will not hesitate to shut off to new outside capital.

Bank Failures, Inflation, Interest Rates, and Macro Tourism:

While I can appreciate that recent bank failures, inflation, interest rates, and other macro-related concerns may be fascinating topics to discuss, I do not believe that they are worth talking about here. These concerns have already been mulled over by countless other fund managers and self-proclaimed financial pundits on TV, and with everyone having vastly different opinions, that probably means that none of them are good. It's important to remember that we are proud macro-tourists, not experts, and while I'm certainly aware of these events, they don't drive our decision-making. Therefore, I don't have anything new or thought-provoking to add to these subjects, so I won't.

Portfolio Commentary:

We started the quarter with three core positions and were able to add three more throughout. However, we ended up selling out of one, netting us five core positions exiting the quarter. While we also have two smaller positions, I don't consider them large enough to fall into the "core" category. As of writing, we still have an outsized cash position, the majority of which is in an ETF that holds 1-3 month treasury bills (since cash is no longer complete trash, and this gives us the flexibility to allocate capital whenever we see fit). I want to clarify that our large cash position has no relation to macro concerns or the like; researching simply takes time, and I am admittedly very selective and have a high bar – there were also some other factors at play that we'll cover next.

In our founder's letter, I made a commitment to transparency and want to discuss our large cash position in more detail. One reason for its current size is a misstep I made earlier in the quarter. Initially, I did not have as many "ready-to-go" investments as I had hoped, and a significant factor was my reluctance to clone other managers' ideas. In retrospect, this was an irrational decision that caused me to overlook some exceptional opportunities that I was already familiar with. As it turned out, some of these ideas performed exceedingly well during the quarter, both from a business and stock price perspective. I believe that self-reflection is very important, particularly

when it comes to investing, and I am firmly over this "cloning" hurdle now. In fact, we currently own some of these ideas mentioned above today.

Quarterly Letter Structuring:

Our future letters are likely to follow a similar structure to this one, but since this is our first-ever quarterly letter, and likely the first time many of you will be introduced to the companies below, I'll be discussing them more in-depth than usual. In subsequent letters, the focus will be on updating you on the positions we hold rather than introducing exclusively new ones all the time.

Additionally, my commentary on the covered names will usually be kept at a high level to ensure it's understandable for most readers. My intention with these letters is not to bore you with all the minutia and financial jargon around our investments but rather to provide a more concise and digestible explanation of why we own a particular investment. I'd also like to keep the letters to a reasonable length while still providing you with enough relevant information. However, if you ever find yourself wanting to know more about a particular investment, please don't hesitate to reach out at any time.

AstroNova Inc. ("ALOT"):

AstroNova is the firm's largest and highest conviction position as of writing. The business has two segments; the first is Test & Measurement ("T&M"), which designs and manufactures airplane cockpit printers; this segment also includes a smaller line of hardware systems used to acquire, record, process, and analyze data for a wide range of industries. The second is Product Identification ("PID") which sells a wide assortment of label printers and the related consumables such as labels and ink.

The crux of our investment in AstroNova revolves around airplane production picking up over the coming years from its current levels. Boeing in 2018 (before the 737-MAX groundings) delivered 806 commercial planes versus just 480 in 2022, and Airbus in 2019 delivered 863 commercial planes versus just 661 in 2022. Going off these numbers means we're still 32% below pre-covid commercial airplane production. I want to make it clear that there is not a demand issue keeping these production numbers below pre-covid levels, but rather a well-publicized supply chain, labor, and manufacturing bottleneck. Boeing is expected to deliver 800 commercial planes in 2025, Airbus is guiding to 1,000 by mid-decade, and Air India just placed orders for 470 aircraft – This order marks Boeing's second-largest of all time by quantity.

AstroNova's cockpit printers come standard on all Airbus A320s, and for Boeing 737s the airlines purchase the printers directly from AstroNova. Their printers are also available on other Airbus and Boeing families of planes, but the 737 and A320 lines make up the majority of commercial airplane deliveries and, as a result, AstroNova's cockpit printer sales. It's important to note that there are no other cockpit printer manufacturers that I am aware of, and after acquiring Honeywell's printer

business in 2018, AstroNova has been left with an **actual monopoly**. One which is further protected by a strict and expensive FAA (Federal Aviation Administration) approval process just to make it on the planes. The market is also niche enough, and its TAM is small enough that large competitors such as HEICO that specialize in reverse engineering aerospace components are unlikely to target AstroNova and its printers.

The question you're likely asking right now is, "Can't that just be replaced with an iPad or computer, and why hasn't it?" The short answer is that they could, but the long answer is that it's unlikely. Let me explain why, pilots like using these printers in most cases, and some even vehemently defend them and don't want them replaced since they can make their work less cumbersome. These printers print off things like weather reports, flight paths, air traffic control data, and other information from ACARS (Aircraft Communication Addressing and Reporting System). Some pilots find it easier to print something off they can write on and hand it to their co-pilot rather than going through ten different menus to get to what they want. Some airlines even send things like flight attendant reassignments through them, making the printers a potentially vital piece of equipment for the airline's operations. Furthermore, the FAA and airlines move incredibly slow when it comes to anything technology; just ask Southwest about their recent debacle in December, which was partially due to their scheduling tech not changing much since the 1990s, according to insiders. Finally, these printers also add a valuable form of redundancy in case of technical failures and allow for the physical documentation of flight records.

I had the opportunity to speak with two pilots a few months back about the printers, and there are also rather lengthy forums online where a past investor had asked pilots questions on the matter, and in both instances, positive things were said about the printers. The printers themselves cost roughly $ 15k-$30k, which is a rounding error in relation to the total $100M+ cost of a commercial plane. This is probably well worth the redundancy it provides, and it's likely not worth saving the 0.02% on new plane purchases while risking troublesome operational headaches that would likely come without having these printers.

In the most recent quarter, the T&M segment beat my expectations, and run-rate EBITDA is now near FY19 levels exiting the quarter. They won several design-ins for defense programs on the data acquisition side of things, and margins continue to progress nicely. I'm expecting continued growth from this segment as commercial airplane delivery ramps-up over the coming years.

PID (label printers) is not some amazing business but should prove to be a fairly recession resistant ~GDP grower since most of their customers sell consumables such as food, beverages, chemicals, etc. Relatively low customer concentration and the recent stellar acquisition of AstroMachine should prove to be an added boon for PID due to synergies and real cross selling opportunities. However, as of the recent quarter the business is once again facing margin pressure primarily stimming from a supplier issue that has led to a substantial portion of printers needing to be fixed. This is the second time the issue has arisen because the original fix they had

started to implement a few months back didn't work. Management expects this issue to be worked through by the end of CY-Q3.

As of writing AstroNova is trading at ~6.5x our CY-2024 estimates. It should be noted that I consider my assumptions to be both conservative and very beatable. Taking a look at other aerospace parts companies, they trade around 15x EBITDA, and this is after some recent multiple compression in the space. While it's true AstroNova has a less attractive non-monopolistic business attached (although we don't think it's bad by any means), they also benefit from a very low maintenance capex of around $3M or so. Applying what I consider to be a more than reasonable 10x multiple on this business gets me to a $24/share with visibility to further upside.

Activision Blizzard Inc. ("ATVI"):

Those familiar with Activision Blizzard will quickly realize this is by no means a small-cap stock and boasts a rather large $66B market cap. While our focus is firmly on small-cap stocks, there will be occasions when I see something in large-cap land that piques my interest.

For those unfamiliar with Activision Blizzard, they are a video game developer and publisher being acquired by Microsoft at $95/share. They develop and own IPs such as Call of Duty, World of Warcraft, Diablo, Overwatch, Hearthstone, and Candy Crush. These are some of the most valuable IPs in gaming, from both a business perspective and a popularity perspective. I've been an avid gamer for years and am not a fan of most of their games (quite the opposite actually), but I can still appreciate how valuable these IPs are. Activision games have some of the lowest expectations in the industry but still sell millions of copies. They are currently churning out a new Call of Duty every other year with practically no differences between the titles, and yet gamers consistently buy these "new" releases, every, single, time. In fact, the most recent release (MW2) was the fastest-selling COD game ever, amassing over $1B in sales in the first ten days after release. Candy Crush has been the top-grossing game franchise in the U.S app stores for twenty-two quarters in a row, and Diablo 4 is very likely to out-sell its predecessor Diablo 3 (30M+ copies over its lifetime) while being just as monetized via in-game skins and DLC's if not better. Throw in the gaming secular tailwind, a highly competent CEO - Bobby Kotick, and I consider Activision to be a great business (what I've stated here is just high level of course).

Valuation wise we have Activision trading at ~16x our 2023E earnings estimate today (accounting for cash and assuming the deal breaks). In my opinion this business deserves a multiple in excess of the market and has averaged an earnings multiple of ~22x over the prior ten years. If we apply what I consider to be a fair 20x multiple and give them credit for their net cash that gets us to ~$101/sh (or ~20% from today and ~36% from our original purchases). We have not sold any Activision and don't plan to unless it's apparent the deal is going through, and that's accurately reflected in the shares price. Given the difficulty in valuing video game developers, we believe our estimate to be fair and see significant upside potential in the name looking out a few years.

I am by no means an arbitrage/anti-trust expert, and we didn't originally purchase Activision for the merger arbitrage either. However, it was on my watchlist at the start of the year, so in mid-January when news came out that the EU would likely deliver an antitrust warning that sent the stock to sub $74/sh I quickly got back up to speed and made our initial purchases (this warning I thought was 100% anticipated, so the stock's reaction was kind of surprising). Then in early February, news started to circulate that the CMA (The UK's antitrust authority) was expected to publish its provisional findings the upcoming week, citing fears that the deal may "significantly reduce competition" – Once again, an expected development, so when the stock dropped on the news, we bought more at ~$72/sh. Fast forward to February 8th and the CMA provisional findings were released, and the stock fell yet again. After taking the time to read their provisional findings and comparing them to recent deals like Facebook acquiring Giphy (which had no behavioral remedies offered, while the Activision deal did), I thought the CMA's comments were better than anticipated, and Microsoft was being offered a real opportunity to plead their case. Given the company's solid earnings a few days prior, we subsequently took advantage and made our final purchases later that day at ~$73/sh. Skip ahead to March 24th, and the CMA dropped its concern around console gaming competition being "substantially lessened" by the deal – Article.

"Having considered the additional evidence provided, ***we have now provisionally concluded that the merger will not result in a substantial lessening of competition in console gaming services*** *because the cost to Microsoft of withholding Call of Duty from PlayStation would outweigh any gains from taking such action."* -Chairman conducting the CMA investigation.

It's important to note that the CMA hasn't ruled on cloud gaming yet, but that should be a smaller hurdle to get over. Another interesting development is that the CMA recently queried seven market participants to get their opinion on the matter, and only one was in opposition – Sony, a real shocker I know! At this point it'd be nice to see the deal go through (It should, in my opinion), but in the event it doesn't, and the stock drops materially, we'll happily add to our position in Activision (I have it sized closer to a special situation right now opposed to a higher conviction idea for this specific reason).

I'll end this part of the letter with a recent interview of Bobby Kotick where he had a funny quip stating, "If deals like this can't get through, they're not going to be Silicon Valley; they'll be death valley" in reference to the U.K.

Cable One Inc. ("CABO"):

Cable One is a rural broadband provider with the majority of their footprint consisting of Coaxial rather than Fiber. For those unfamiliar with Cable One (Sparklight Internet), you can compare them to their larger, more well-known peers like Charter (Spectrum) or Comcast (Xfinity).

There are however some important distinctions to make; unlike Charter and Comcast, they started to pivot away from TV subs back in 2013, and thus, their EBITDA margins are higher than

the rest of the industry (~53% for CABO versus ~40% for Charter). This is because TV subs are basically a zero-margin business and contributed only ~25% of residential revenue for Cable One in 2022 but ~42% for Charter (lower margin, but still profitable for Charter). Funnily enough, I have been shocked at how often cable bears bring up TV subs as a concern on these names, not realizing they contribute nothing to the bottom line and are just a drag on margins. Another contributing factor to Cable One's higher margins is their industry leading ARPUs (Average revenue per user), which should continue to grow moving forward.

This is easily our most controversial/contrarian position as of writing; just go look at Cable One's, Charter's, Comcast's, or any other cable company's share price over the past two years – most are down 50%+ from the highs. There are several reasons for this; some include but are not limited to, multiple compression after substantial expansion in recent years, interest rates rapidly increasing, and since these names are levered, market participants are more hesitant to own them (4x EBITDA in Cable One's case), Fiber overbuilds increasing, and a new competitor in the form of 5G Fixed Wireless Access "FWA."

The first (multiple expansion) is no longer an issue, as Cable One is trading at less than 7.0x LTM EBITDA and less than 9.0x LTM run rate FCF, down from a peak EBITDA multiple of ~21.0x on an NTM basis. The second is also not a problem, their current blended interest rate is ~3.86%, ~75% of their debt is fixed, and the majority is not maturing until 2028 or later. The third (Fiber) is an overstated risk and has been for a while, and the verdict is still out on the fourth (FWA).

Up until recently, Cable One enjoyed a positive reputation in the market and received a premium multiple thanks to its rural footprint, lower penetration rate, phenomenal management team, and higher margins when compared to its peers. However, due to the emergence of Fixed Wireless Access, its rural footprint is now being perceived as a liability. Below I'll discuss fiber overbuilds and then elaborate on the potential impact FWA is going to have on them.

The cost of fiber overbuilding is substantial, which is why when competitors evaluate potential markets to overbuild, rural markets like most of Cable One's are typically at the bottom of the list, if they are considered at all. It just doesn't make economic sense to lay the same amount of fiber in more rural markets when you can pass more homes in a suburban area for the same cost. To further prove this point, fiber competitors have overbuilt ~25% of Cable One's footprint compared to 40%+ for Charter. Regardless, overbuilds are nothing new to any Cable operator, and it takes several years, not weeks, for Fiber to start taking share from Cable, and in markets where Cable and Fiber do compete, they end up splitting the market 50/50. There are various reasons for this, but the primary reason is that, as of today, Coax and Fiber are essentially the same product, with the most significant difference being the symmetrical speeds offered by Fiber (Same upload speeds as download). A very, very, very small portion of broadband consumers need this upload speed, and Coax will soon be capable of offering symmetrical speeds as well as download speeds of 5GBs+ with the rollout of DOCSIS 4.0. Fiber is a superior product undoubtedly, but its advantages

as of today (or the next several years, for that matter) aren't material. While Fiber overbuilds were ramping up significantly in recent years for various reasons (including 0% rates), they are now headed in the opposite direction, with essentially every fiber overbuilder cutting their 2023 build estimates significantly because of rising cost and lower IRRs – I don't expect this trend to change anytime soon.

FWA can be thought of as a permanent 5G hotspot in your home. The technology is inferior to both Fiber and HFC (Hybrid Fiber-Coaxial) and can experience frequent dropouts. In addition, its speeds can start off well but slow down significantly as more people join the network, and during times of heavy use, FWA is deprioritized by carriers who prioritize their mobile customers. While it is true that FWA providers like T-Mobile have gained a substantial number of FWA customers in recent quarters (~500k every quarter for the past three), I don't anticipate that they will continue to add subscribers at this pace. Moreover, I believe it is unlikely that FWA poses a greater threat to Cable Companies than Fiber does.

As previously mentioned, Cable One's footprint was once regarded favorably because they were less vulnerable to Fiber overbuilds. However, that same footprint is now seen as a disadvantage due to the perception that FWA is a threat to rural markets. I don't necessarily agree with this notion, and Cable One's typical market isn't in the middle of nowhere, with approximately 60,000 homes passed on average. These are not the same types of "rural" markets that would justify FWA deployment. The impact of FWA on a particular area or market depends on several factors. In urban areas, the presence of more infrastructure, such as towers, allows for the deployment of more mid/high-band spectrum, which provides higher speeds but covers a smaller area. However, urban areas also mean there are more users on the network, resulting in capacity constraints (This constraint is why when spectrum comes up for auction, mobile carriers bid it up substantially – they can't create more of it). Conversely, in rural areas, there may be a lack of infrastructure, and lower bands may be required to cover the area needed, resulting in slower speeds but wider coverage. In certain cases, rural areas might have extra spectrum due to fewer customers, but this could also result in slower speeds if it's a lower band covering a wide area. To sum up, FWA has both pros and cons in rural and urban areas, so I do not believe that rural broadband providers are at a disadvantage compared to their urban counterparts. Customer demand comes from both rural and urban areas. For instance, T-Mobile states that around two-thirds of their FWA additions come from their top one hundred largest markets, while the remaining one-third is from smaller markets and rural areas. It should be noted that T-Mobile is not deploying 5G small-cell radios specifically for FWA. Instead, they offer this service only in areas where they have extra capacity in their networks. FWA customers typically consume ten times more data than mobile users, resulting in lower returns on their investment and, as a result, are given lower priority during times of peak usage.

To save time, let me conclude with some final remarks on FWA. Customers seem to be less satisfied with the service than before. A quick glance at the T-Mobile ISP subreddit reveals numerous negative reviews, where people frequently report speeds below 100 Mbps. A year ago, the same subreddit was full of positive feedback, but today, positive reviews are often met with comments such as "Come back to us in six months when more users join the network." Moreover, the price of FWA, which is around $50 per month for non-bundled T-Mobile customers, is not much cheaper than coaxial or fiber internet. Finally, it is worth noting that the former chairman of the FCC, who approved millimeter-wave technology for 5G FWA, described it as an "interim technology."

As of writing, Cable One is currently trading at ~7.0x LTM EBITDA (for clarity, we do give them credit for the book value of their investments, which I believe to be conservative and think these assets are likely worth more than they are listed on the balance sheet for), and 9.0x our run-rate FCF estimate before accounting for their investments – if you tack them on at book, you're at ~6.5x. These multiples seem far too low for a business that still has an essential monopoly in 65% of its markets while providing what is practically a necessity today (home internet). If the FWA risk proves to be overblown, I expect Cable One's multiple to expand back to or above pre-covid levels, which on LTM numbers today gives us an incredible upside opportunity.

Conclusion:

While we acknowledge that the current market environment is clouded with uncertainty, it's important to remember that this isn't an uncommon occurrence in the grand scheme of things. We should continue to expect occasional periods of uncertainty for years to come. However, during these times, it's important not to stray from our principles, and as long as we continue to invest in high-quality businesses at attractive prices, we are confident that we will emerge from these periods in a favorable position.

In conclusion, I am humbled by and grateful for the opportunity to invest your capital alongside my own, and will continue to make every effort to compound that capital at attractive rates.

Cordially,

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"The basic story remains simple and never-ending. Stocks aren't lottery tickets. There's a company attached to every share." – Peter Lynch

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