Q4-2023 Letter

Dear Partners, **January 16th, 2024**

Atai Capital returned 12.7% in the fourth quarter, bringing our full-year 2023 returns to 20.0% net of all fees. This compares to a 26.3% total return for the S&P 500 and a 16.9% total return for the Russell 2000. Despite our performance trailing the S&P 500 by 6.3% this year, I am still satisfied with our total net return of 20%. This return was achieved with a substantial cash position throughout the year while also not being particularly concentrated, and despite many of our ideas rallying into the year-end, our portfolio's prospective returns remain incredibly attractive today.

Previously, I wrote that Bel Fuse had increased its intrinsic value significantly, and I am happy to report that another one of our companies, AstroNova, has followed suit. We'll provide you with an update on AstroNova later in this letter.

Portfolio Commentary:

We added three small positions throughout the quarter and increased our size in a few existing positions. As for turnover, we sold out of one small position after our thesis did not play out as expected, netting us two additional positions in the quarter.

We have ~17% cash left to deploy, and I expect we'll be in mid-single digits of cash or near fully invested by the end of the first quarter. Our concentration is the highest it's been since inception, and our top five positions account for ~60% of our portfolio. The rest of the portfolio mainly consists of several LSD-MSD positions that have the potential to receive incremental capital over the coming months.

Given my selective nature when it comes to ideas, we sat in what I consider to be far too much cash in our first year and still have a decent chunk left to deploy. Seeing how this decision was/is not related to macro concerns or the like, I decided it was best to significantly accelerate our velocity of ideas by creating a more systematic idea-generation and monitoring process. The hope in doing so was straightforward – to have more ideas hit my desk more often and to better monitor things we're not interested in today but might be at some point in the future. My expectation is this new process is likely to yield many more investible ideas as we move forward.

Another contributing factor to our significant cash position throughout 2023 was my preference towards starting most of our positions on the smaller side and adding to them over time as their respective theses play out and we get more comfortable with the businesses. The drawback to this is that it left us with quite a bit of cash throughout our first year, but with a portfolio now consisting of several small but promising ideas and our new idea-generation process, I expect this won't be much of a problem moving forward.

AstroNova Inc. ("ALOT") Update:

In our Q2-2023 letter, I wrote that I expected AstroNova's EBITDA to nearly double sometime over the next 12-24 months as narrowbody aircraft production continued its recovery. Since then,

AstroNova has made significant progress towards this goal, and in their most recent quarter, AstroNova went from a run-rate EBITDA of $14.5M ($12.4M at the end of Q2) to $22.5M. However, this significant increase in EBITDA came not on the back of narrowbody aircraft production but instead from AstroNova's traditional label printer business - product identification.

EBIT margins for their product identification segment jumped ~650bps q/q (11.5% -> 18.1%). This was a pleasant surprise and significantly increased AstroNova's intrinsic value since we were giving little credit to this segment initially. However, this significant margin increase left us with more than a few questions. Consequently, we scheduled a call with AstroNova's executive team after the quarter. We pushed them rather relentlessly to try and nail down any one-times that might have contributed to this increase, but despite our prying at the sustainability of these margins, we couldn't get them to budge. Having said that, we couldn't get them to give us a clean bridge on the margin expansion either. They mostly pointed towards mix + pricing for the increase and gave some examples, such as sunsetting one older printer model that they were selling for B/E.

Despite having no clean bridge on the q/q margin increase, we can take some comfort in knowing that there are still several things working against them:

- They've only hit $450k in benefits this quarter from their restructuring initiative, which is expected to be at least $2.4M annually - implying 50bps+ in additional margin expansion.
- They are still working through retrofitting Trojan Label printers that have had ongoing ink issues. Since these printers aren't operating, AstroNova isn't benefiting from their ongoing ink/label sales, which, as you can imagine, are higher-margin products.
- They've had/have higher than normal warranty expenses and extra technical support costs related to the ink issues/retrofitting.
- They guided to similar margins for product identification in Q4, and if there weren't any one-times during the quarter, it seems possible that margins could expand further.

While we remain skeptical about the sustainability of these margins, at AstroNova's current price of $17.00 or ~5.50x normalized EBITDA, it doesn't matter – margins could revert materially, and a substantial amount of upside would still remain. We aren't modeling margins increasing from here, but we also wouldn't be shocked if they did, and any margin decline would more than likely be offset by the puts and takes above, at least partially.

AstroNova now has a clear path to generating $28M in EBITDA or more in reasonably short order (12-24 months). We believe a 10.00x EBITDA multiple (~12.50x FCF) for this business is reasonable and gets us to $34.00/share, and we still see room for additional upside beyond that.

Modeling and Forecasting:

Those who know me know that I rarely (never) construct complex models that attempt to forecast next quarter's earnings by employing ten different KPIs to achieve a precise yet ultimately incorrect forecast. It's not about lacking the capability or information to do so; rather, I see such

complex forecasting as mostly pointless. When I've decided to take a position in a company, we aren't looking for them to beat next quarter's estimates or even this year's guidance. Usually, when we enter a position, we're looking for the company to materially grow its after-tax cash flows over the next two to three years. Consequently, as a result of this approach, we have little interest in trying to predict whether a company will beat or miss earnings estimates by $0.02. Moreover, we've seen numerous situations where a company reports a good quarter, and the stock actually drops double digits the next day and vice versa – This just isn't the type of game we want to play or are trying to play.

Furthermore, we rarely (never) build three-statement DCFs and usually don't forecast our businesses out more than three years. There are several reasons for both, but we find DCFs to be unproductive. Most of your value in a DCF is typically in your terminal anyway, and they also require you to make several speculative estimates, colloquially referred to as SWAGs (scientific wild-ass guesses). Additionally, DCFs are easily manipulated to output the analyst's desired outcome. As humans, we all fall victim to implicit biases, and by building out a complex model, you routinely risk bringing two into play: 1. Sunk-cost fallacy and 2. overconfidence bias. I generally believe that if I need to build out a DCF or some complex model, the idea should almost always be a pass – the opportunity should be so great that only fifth-grade math is required. I think Peter Lynch put it best when he said, *"If you can add 8 and 8 and get reasonably close to 16, that's the only level of math you need to know."* – *video of Peter Lynch here.*

Moreover, there are usually many puts and takes when forecasting a business's future – several of our portfolio companies don't even provide guidance! For example, maybe segment A's margins expand faster than you expected, but the segment you liked is growing slower than expected, or perhaps the company's restructuring ends up netting them more savings than initially anticipated or less. With plenty of moving parts at most businesses, I prefer to look for situations where I can answer "Does it matter?" to most questions and concerns other investors might have. For example, does it matter if AstroNova's product identification margins normalize at a lower level? The answer to this question is no, it doesn't. Would that take away from the upside? Sure, but AstroNova would still be worth somewhere in the mid-high twenties if that were to happen (compared to $17/share today), so it doesn't matter. This same "Does it matter?" theme rings true with many of our investments.

I've spoken about this before, but at the end of the day, we are outsiders acting on imperfect information and making assumptions from afar. There will always be things we aren't aware of, no matter how much research we do or how intimately we think we might know a company. As minority shareholders, we are not in control of these businesses we invest in and are essentially outsourcing the business's management and capital allocation to someone else. This isn't to say we don't know our investments well; we do, but I prefer situations where I can answer "Does it matter?" to most questions instead of situations where I have to make aggressive assumptions about the future or build intricate models.

Upside Optionality:

I like my ideas with what I call "upside optionality." Other investors might commonly refer to this as a bull case, but I don't like to think about it that way, and it doesn't have much pull in my purchase decision or valuation (I never probability weigh anything). When I "model" out a company, I tend to lean toward the draconian side of things, and if my low expectations still lead to an attractive amount of upside in a name, that's usually when a purchase decision is considered.

I try to find ideas with substantial amounts of *free* upside optionality. These situations are scarce, and in most cases, the upside optionality is either unlikely to materialize or we have to pay up for it – and I wouldn't say I like paying up for the *chance* of outsized returns! In an ideal scenario, I'll get to purchase a company for much less than its current value today, and I won't have to rely on overly optimistic assumptions to generate significant returns. If a company's upside optionality comes to fruition, great; if not, well, I still make money. Put simply, upside optionality is the cherry on top, which we give no credit for but is still nice to have when possible.

For example, when we first bought Bel Fuse, we did *think* that 20% EBITDA margins were a possibility. Still, we didn't model the significant margin increase Bel Fuse saw over the past year, but we didn't need to – the name was attractive regardless, and this upside optionality was free. Fast-forward to today and Bel Fuse has captured that upside and is now worth far more than what we initially modeled it at. While Bel Fuse has exceeded our expectations (and continues to do so), we knew from the get-go that something similar to what Bel Fuse has accomplished was a real possibility (not just a dream or 1% chance), and those are exactly the type of upside optionality situations we look for.

While no one could have predicted (with any certainty) that AstroNova's product identification margins would expand so quickly or Bel Fuse's consolidated EBITDA margins would do the same, it was always a possibility, and when you invest in good businesses with good leaders, situations like this seem to be recurring in nature – good ideas/businesses will surprise to the upside, and when such opportunities arise, it's prudent to place a significant bet.

Conclusion:

I want to conclude this letter by, first and foremost, thanking those of you who chose to entrust me with your capital this year despite my lack of an auditable track record. Through the lens of hindsight, there were undoubtedly some things I could have done better, but I am confident that the mistakes made and lessons learned will help drive our success in the future.

Over the past year, I was able to significantly broaden my network with numerous fund managers that I have respect for. These connections act as a valuable source of feedback for the ideas we own or are thinking of owning. These managers, like me, tend to be opinionated and very likely to speak their minds, and when it comes to investing, I find this to be an invaluable asset and one I

am incredibly fortunate to have. I also expect that our network will continue to be an ongoing source of great ideas.

As a reminder, we are open to new clients, and if you know someone who might be a good fit, please feel free to pass my contact information along – we do plan on increasing our fees for new clients in the first half of this year and will be sunsetting our Founder's class fee structure.

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

Cordially,

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"The difficulty of determining what any stock is really worth is very great indeed. No two security analysts will agree on the worth of a stock, or even on the definition of the word."
– John Templeton

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