Fairlight Alpha Fund LP

Q4 2022 Letter

Dear Partners,

Fairlight Alpha Fund's fourth quarter 2022 returns were 28.3% net of fees. This compares to 7.9% for the S&P 500 Total Return index. Returns for the full year 2022 were 16.1% for the fund, compared to -18.1% for the S&P 500. Overall, since inception the fund has returned 399.1% net of fees and 52.0% on an annualized basis. The fourth quarter saw a rebound in the market which we managed to outperform.

Performance vs. the S&P 500

We track the net asset value of Fairlight Alpha Fund (the "Fund") over time as calculated by our fund administrator based on our portfolio positions and prices over time on a dollar basis. The fund financials are also audited each year by an independent auditor with the assistance of the Fairlight management company and the fund administrator.

The tables below show the S&P 500 total return and partnership net returns, after fees, for each year 2019-2022, followed by the compounded returns over the same period, as well as the annualized gains.

Annual Returns

Year		Fairlight Alpha Fund	S&P 500 (Total Return)	Difference
2019[1]	……………………..........	38.1%	17.9%	20.1%
2020	…………………………	26.3%	18.4%	7.9%
2021	…………………………	146.5%	28.7%	117.8%
2022	…………………………	15.8%	-18.1%	33.9%

Compounded Returns

Year		Fairlight Alpha Fund	S&P 500 (Total Return)	Difference
2019[1]	……………………..........	38.1%	17.9%	20.1%
2020	…………………………	74.4%	39.6%	34.7%
2021	…………………………	329.9%	79.7%	250.2%
2022	…………………………	397.9%	47.2%	350.7%
Annualized Gain	…………………………	52.0%	10.6%	41.3%

(1) The S&P 500 returns represent the total return index, i.e., with dividend reinvestment included. Increases in value arise from stock price appreciation as well as dividend reinvestment. This provides a fairer comparison to the fund.
(2) The Fairlight Alpha Fund performance is shown net of partnership fees and expenses.

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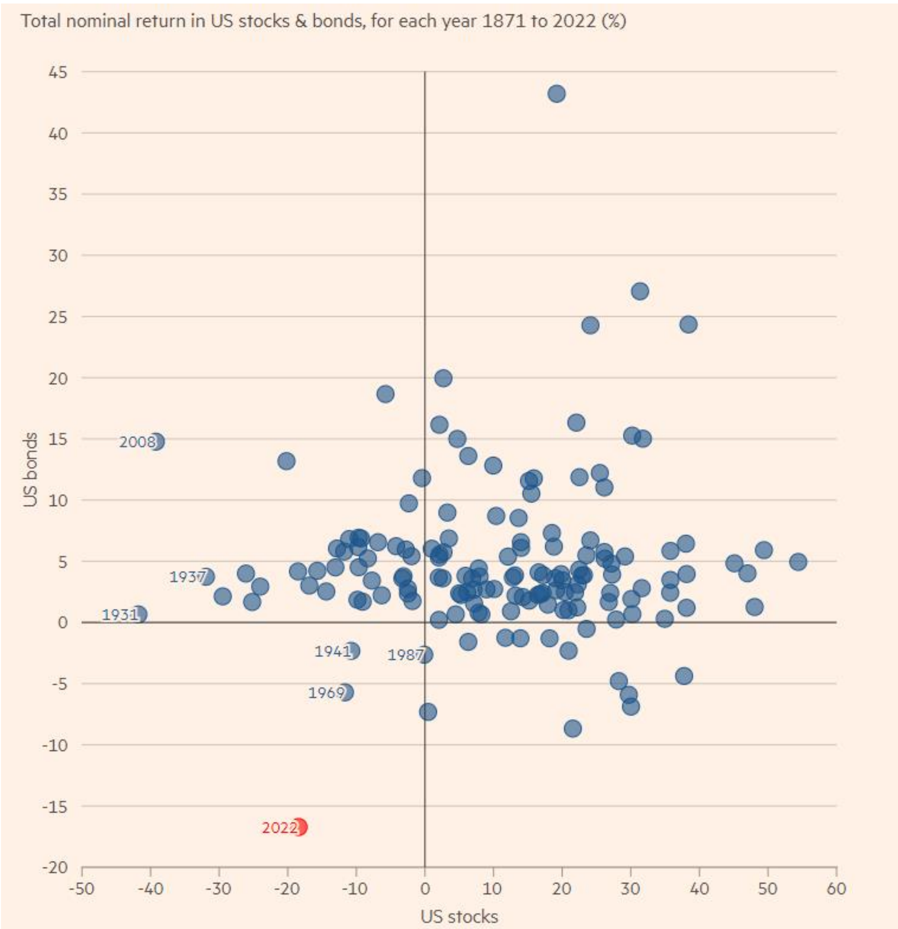
[1] The Fairlight Alpha Fund was launched on 01-Mar-2019 and so the 2019 performance and any returns are presented for a 10-month period.

The fund outperformed and achieved a positive return for the year, in spite of the bear market headwinds. We believe there is still more we could do to find ideas at an even earlier stage, although we have historically found ideas very early. We are currently working hard to continually improve our idea generation efficiency and processes. Idea generation speed is a key driver of our returns and fund performance.

Current Market Conditions

A year of market conditions like 2022 gives one a newfound respect for successful money managers. Anyone who grew AUM or had positive performance has shown that returns were truly alpha and not correlated, market beta driven. To highlight the unusual nature of last year's market we show the chart below, which we find extremely striking, for the historic returns on US stocks and US bonds over the last 151 years.

Table 1: Nominal return for US stocks and bonds from 1871-2022. Source: Financial Times.



The performance of the "classic portfolio" of 60% stocks and 40% bonds experienced its worst returns since 1932, and US bonds recorded their worst performance ever. Furthermore, the real estate market in the US and other regions is experiencing a correction as the impact of inflation and rising interest rates take effect. All liquid asset classes have seen a decrease in 2022, with the real estate market now also showing signs of decline.

Although inflation is still high compared to levels seen over the last two decades, there are some early signs of a peak and cooling of inflation. The year-on-year rise to December 2022 was 6.5% for US CPI, compared to 7.1% for November and 7.7% in October. This is being driven by the drop in energy prices, but with other factors still showing high levels of increase such as transportation and food (the price change of eggs was 59.9%!). Although we are by no means expert in macro predictions, we detail some thoughts on the overall market in the next section.

Market Performance in 2022

In the following section, we will review the performance of global markets for 2022. This shows the variations in local markets and performance in the last year. Most Asian and Western markets have undergone corrections of over 10%, but with some notable exceptions. As you will see in the table the FTSE-100 and STI outperformed versus other indexes. We have also included the trailing 12-month PE ratio across each index.

Table 3: 12-Month Comparison of Global Stock Market Indexes vs. December 31, 2021

Market	Dec 31, 2021	Dec 31, 2022	Change %	PE[2]
S&P 500	4,766	3,840	-19.4%	18.4
DJIA	36,338	33,147	-8.8%	21.7
NASDAQ Comp	15,645	10,466	-33.1%	21.3
FTSE 100	7,385	7,452	-0.9%	11.5
DAX	15,885	13,924	-12.3%	13.7
CAC 40	7,173	6,474	-9.7%	11.2
SSE Comp	3,640	3,089	-15.1%	12.0
Hang Seng	23,398	19,781	-15,5%	11.7
STI Singapore	3,124	3,251	4.1%	9.3

There was a recovery across most markets from the last quarter with the notable exception of the NASDAQ Comp. The overvaluations there still appear to be playing out. But most striking we find that in the above table there are large valuation differences between US and non-US markets. Although we follow a primarily bottom-up approach to investing and pick stocks on an individual basis, it is still helpful to look at the backdrop to each market. The relative valuation helps explains the outperformance of the FTSE and STI indexes which, because they weren't that overvalued in the first instance, have not fallen in the same way as many other markets. Although we don't use the above index level data or performance as a specific filter on our investment searches, it is useful to have at the back of our minds when reviewing stocks. Perhaps it couldn't happen here, but there could still be further declines in US markets in the coming year.

The above picture is borne out when we look at individual stocks in each market. SE Asia still appears cheap relative to the US even given the market movements last year. Although pockets of value are appearing the number of interesting investment opportunities still seems to be biased towards non-US positions. That being said we are still finding some very interesting situations in the US where changes in the business outlook in specific stocks are being hidden by changes in expenses, revenue mix or quasi special situation opportunities.

We mention all of this because although we first and foremost focus on stock picking it can be a little helpful to take a step back and review the overall market valuation in whichever market or sector one

[2] This is the trailing 12-month PE ratio for each index.

happens to be looking through (on a stock-by-stock basis). We look at individual stocks and any market can potentially throw up exciting new investments: it is just less likely in an overvalued market. If you want to catch more fish, you have to go where the fish are. Another point to mention here is that stock market dispersion of returns can also be an indicator of where we should be looking. There have been some great studies such as Putnam Investment's work on international small caps, indicating that small-cap and international small-cap stocks have typically displayed a wider range of returns over time.

Stocks in the United States

Although we are generally finding more value in non-US markets, there are now more areas of value appearing in US markets. One such area is in the US banks where we see specific names that have fallen to levels that indicate good value. These can be quasi special situation or relate to mergers and acquisitions. We have analysis in several situations using the wealth of publicly available data. Here we find that the increased levels of regulatory reporting since 2008-2009 are extremely helpful to smaller investors and investment funds. One particular US bank name has caught our attention and we are currently building a position. We will discuss this further in the next letter.

As previously mentioned, we have positions in the ECIP banks M&F Bancorp (the holding company for M&F Bank) and Citizens Bancshares Corporation (the holding company for Citizens Trust Bank). We have continued to monitor these as the thesis evolves and still feel that this situation has not fully played out as yet. In order to try and estimate the potential future fair value of these positions we have performed a calculation based on assets and leverage.

Our analysis suggests that MFBP and CZBS are undervalued by a factor of 2.7 and 3.4 respectively, based on conservative assumptions. We determine the final value by using a conservative earnings multiple from the end of 2021 (PE ~6-7). The growth in earnings is calculated using historical investment security and loan income, as well as an increase in assets (using ECIP capital) with the same capital ratios as before 2021. We have assumed that expenses will increase by 75% in line with the increase in income, which is likely to be lower due to economies of scale. The earnings level is also conservative given rising rates, and capital ratios may be made more efficient with the help of the national banks helping the ECIPs. For example, Citi has seconded a senior technologist as CTO to M&F Bank at no cost and included them in a $1.23 billion syndicated loan deal. One headwind is likely to appear from increases in loan provisions in the next few quarters as the economy cools, but this may be more than offset by growing loan books and net interest margins.

In addition to the bank analysis above we have also started to build a new position in a US-listed small-cap tech stock Opera Ltd. (OPRA). This is a business where the revenue growth picture and earnings over the last 12-18 months have been ciphered by temporarily inflated costs. But the growth in revenue is now beginning to show through and should become more obvious in the next few quarters. This company also has a significant amount of cash, cash equivalents and marketable securities.

There have also been recent developments relating to the above stock occurring during the writing of this letter. At the beginning of 2023 the stock was trading in the $6.00 area at a market cap of $550 million, but on January 12 the company announced the distribution of a $0.80 (per ADS) dividend. The stock has re-rated somewhat to $6.90, but we believe still represents great value.

The company has cash of $166 million and marketable securities of $35 million as of Q3 2022 (even after share buybacks from Q4). There are also additional cash balances that the company is earning out from non-core investee companies that Opera has divested. The total amount of the above dividend comes to $71 million of which $59 million is being paid for from marketable securities sales (implying large gains on these for the company in Q4). So, the net of this is that cash will only be reduced by $12 million.

Taking the above into account at the current share price of $6.90 we reach an EV per share of $4.72 with our estimate for earnings before tax of $0.90 per share. In addition, we believe the company's pivot in strategy to focus on higher revenue generating customers is beginning to (literally!) pay dividends. The ARPU for Opera users has risen from below $0.75 to $1.06 in the last 12 months as the company has rapidly grown the Opera GX user base to 20 million (a specialist gaming browser that has an average of $3 revenue per customer)[3]. We will discuss this further in due course, but there are also some additional sales expenses incurred through 2021 and H1 which have obscured the earnings picture. And all of this is before any discussion on future opportunities with advertising or new browser types: anyone for a dedicated sports browser?

Outlook for the Remainder of 2023

The outlook for 2023 is in some ways clearer than 2022 and in other ways not. Earnings estimates for the S&P 500 have been falling, e.g. J.P. Morgan recently lowered estimates from $225 to $205. This level of earnings and the market price of 3970 (as of the time of writing this letter) implying a PE of 17.6 for the prior estimate and 19.4 for the revised. These levels are higher than historical averages, but not by a large margin. There are still large amounts of dispersions in the valuation levels in the market (after reaching a recent peak at the end of 2019). Fortunately, we invest in stocks rather than markets and so we remain macro-aware and micro-obsessed[4]. And because we don't trade the markets themselves, we will keep them in the rearview mirror when driving forwards.

Thanks to all our partners for your commitment to us in the past few years. We will once again work tirelessly to generate above market returns this year.

Yours,

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[3] See the Opera Ltd. October 2022 investor presentation available on their investor relations site.

[4] See "Be Macro Aware, Micro Obsessed: Channeling our inner Bezos", from the Substack of Shomik Ghosh. In turn paraphrased from Jeff Bezoz who said that Amazon is "competitor aware, customer obsessed".

THIS IS NOT AN OFFERING OR THE SOLICITATION OF AN OFFER TO PURCHASE AN INTEREST IN FAIRLIGHT ALPHA FUND LP (THE “FUND”). ANY SUCH OFFER OR SOLICITATION WILL ONLY BE MADE TO QUALIFIED INVESTORS BY MEANS OF A CONFIDENTIAL OFFERING MEMORANDUM AND ONLY IN THOSE JURISDICTIONS WHERE PERMITTED BY LAW.

AN INVESTMENT IN THE FUNDS IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. OPPORTUNITIES FOR WITHDRAWAL, REDEMPTION AND TRANSFERABILITY OF INTERESTS ARE RESTRICTED, SO INVESTORS MAY NOT HAVE ACCESS TO CAPITAL WHEN IT IS NEEDED. THERE IS NO SECONDARY MARKET FOR THE INTERESTS AND NONE IS EXPECTED TO DEVELOP.

THE FEES AND EXPENSES CHARGED IN CONNECTION WITH THIS INVESTMENT MAY BE HIGHER THAN THE FEES AND EXPENSES OF OTHER INVESTMENT ALTERNATIVES AND MAY OFFSET PROFITS. NO ASSURANCE CAN BE GIVEN THAT THE INVESTMENT OBJECTIVE WILL BE ACHIEVED OR THAT AN INVESTOR WILL RECEIVE A RETURN OF ALL OR PART OF HIS OR HER INVESTMENT. INVESTMENT RESULTS MAY VARY SUBSTANTIALLY OVER ANY GIVEN TIME PERIOD.

THE PERFORMANCE DATA SHOWN HEREIN REPRESENTS THE PERFORMANCE OF THE FUND. THE RESULTS REFLECT THE DEDUCTION OF: (I) AN ANNUAL ASSET MANAGEMENT FEE OF 2%, CHARGED QUARTERLY; (II) A PERFORMANCE ALLOCATION OF 20%, TAKEN QUARTERLY, SUBJECT TO A “HIGH WATER MARK;” AND (III) TRANSACTION FEES AND OTHER EXPENSES ACTUALLY INCURRED BY THE FUND. THE RESULTS REFLECT THE IMPLEMENTATION OF THE INVESTMENT STRATEGY DESCRIBED IN THE FUNDS’ OFFERING DOCUMENTS AND APPLIED IN THE FUNDS’ TRADING ACCOUNTS. ALL INVESTMENTS INVOLVE RISK, INCLUDING THE LOSS OF PRINCIPAL.

RESULTS ARE COMPARED TO THE PERFORMANCE OF THE S&P 500 TOTAL RETURN INDEX (THE “COMPARATIVE INDEX”) FOR INFORMATIONAL PURPOSES ONLY. THE FUND’S INVESTMENT PROGRAM DOES NOT MIRROR THE COMPARATIVE INDEX AND THE VOLATILITY OF THE FUND’S INVESTMENT PROGRAM MAY BE MATERIALLY DIFFERENT FROM THAT OF THE COMPARATIVE INDEX. THE SECURITIES OR OTHER INSTRUMENTS INCLUDED IN THE COMPARATIVE INDEX ARE NOT NECESSARILY INCLUDED IN THE FUND’S INVESTMENT PROGRAM AND CRITERIA FOR INCLUSION IN THE COMPARATIVE INDEX ARE DIFFERENT THAN THOSE FOR INVESTMENT BY THE FUND. THE PERFORMANCE OF THE COMPARATIVE INDEX WAS OBTAINED FROM PUBLISHED SOURCES BELIEVED TO BE RELIABLE, BUT WHICH ARE NOT WARRANTED AS TO ACCURACY OR COMPLETENESS. UNLESS NOTED OTHERWISE, THE RETURNS OF THE COMPARATIVE INDEX PRESENTED HEREIN DO NOT REFLECT FEES OR TRANSACTION COSTS, BUT THOSE RETURNS DO REFLECT NET DIVIDENDS, IF ANY.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.