Alphyn Capital Management, LLC
100 Duffy Avenue, Suite 510
Hicksville, NY 11801
samer@alphyncap.com
www.alphyncap.com

Letter to investors, Q1 2022

Performance

As reported by our fund administrator, the Master Account, in which I am personally invested alongside SMA clients, returned -13.4% net in Q1 2022. As of March 31, 2022, the top ten positions comprised approximately 69% of the portfolio, and the portfolio held approximately 2.5% in cash.

	ACML	S&P500 TR
2019	18.9%	31.5%
2020	4.6%	18.4%
2021	13.9%	28.7%
2022 YTD	-13.4%	-4.6%

ACML performance is net of fees and standard costs.

Volatility is "a feature and not a bug" of the markets

It has been a bumpy start to the year, but market drawdowns are not unusual, as the table below shows. To quote Bruce Flatt of Brookfield Asset Management, "Wars, explosions, recessions — all those things, they come and go. And they're really important at the time, but in the fullness of time, if you have good businesses in great places and keep compounding returns, you'll earn excellent long-term returns."[1]

While volatility can be painful, it is the price we pay for the opportunity to acquire attractive companies at reasonable prices. The goal remains to build and refine a portfolio of such companies.

Frequency and duration of stock market pullbacks

Drawdown threshold	Historical frequency	Typical # per year	Typical recovery time
20%	Once per cycle	<1	20 months
10%	Once per year	1	8 months
5%	Once per quarter	4	2 to 3 months
3%	Once per month	11	2 to 6 weeks
2%	Often	18	1 to 4 weeks

Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

[1] https://www.bnnbloomberg.ca/brookfield-billionaire-bruce-flatt-reveals-secret-behind-3-700-return-1.1747968

Portfolio – top and bottom performers[2]
This quarter I am changing up the format of the letter, presenting the top and bottom contributors to performance, and discussing any changes to the portfolio (additions, subtractions, or significant corporate actions).[3]

Top Performers	Contribution	Bottom Performers	Contribution
Fairfax Financial Hld.	1.16%	Exor NV	-2.18%
Vaneck Gold Miners ETF	0.95%	KKR & Co. Ltd.	-1.69%
Amazon.com Inc.	0.22%	WANdisco Plc.	-1.55%
Trebia	0.17%	Liberty Broadband Corp.	-1.50%
Cash	0.06%	Naspers. Ltd.	-1.34%

As calculated in the Master Account brokerage statement.

Fairfax Financial
Fairfax's business model advantages were on display as the company disclosed record net profits of $3.4bn for 2021 and grew book value per share by 34%.

The company's insurance operations collect money upfront in premiums but pay out claims over several years. The difference between premiums collected and claims paid is called the float. Float is "other people's money" that Fairfax can invest for its benefit. Float is a cheap, safe form of "synthetic leverage." Unlike regular debt, float cannot be margin called, and unlike debt, Fairfax pays no interest on its float so long as the insurance operations are profitable, which they have been for the past 16 years. In 2021, Fairfax earned $801m in underwriting profits.

Fairfax had a $48bn average investment portfolio in 2021, of which $25bn was funded by float. While the investment returns on the total portfolio were 9.4%, the tremendous leverage afforded by float (combined with insurance profits, share buybacks, and after costs) produced a 34% growth in book value per share. These results are more impressive considering half the investment portfolio was allocated to cash and short-term bonds. Float should drive attractive returns for years to come. Float per share has compounded at 19% since inception and 10% over the last five years. Moreover, Fairfax achieved this with disciplined underwriting standards.[4]

Fairfax is undervalued at only 0.7x book. In contrast, Berkshire Hathaway offered to acquire Allegheny for approximately 1.25x book, and Markel trades at a similar valuation. Fairfax's suboptimal 5-year investment performance caused the negative sentiment. Contributing factors include the company's strict adherence to a value-investing discipline, focus on underperforming emerging markets, and loss-making macro hedges.[5] However, all of these are temporary; as the company demonstrated in 2021, it can still produce attractive returns.

Gold miners
Uncertainties regarding inflation, equity valuations, and economic growth post-Covid were constructive to gold. Moreover, the sad developments in Ukraine and follow-on effects on global energy markets reinforced gold's haven attributes. Therefore, having a mid-single-digit percent of our capital invested in gold hedges remains prudent and could provide future liquidity.

---

[2] There is no assurance that any of the securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable. See "Disclaimers" at the end for more details.
[3] The SEC has rules on "cherry picking," or not presenting specific investment advice in a fair and balanced manner. Presenting "winners" and "losers" and giving both sets equal prominence in the discussion satisfies these rules.
[4] See the "Loss reserve development" tables in the annual reports.
[5] Writeup by @onebeggar twitter.com/onebeggar/status/1504801467571519490?s=20&t=ngGZu7AGYSIFHepCyPzxcA

Amazon – add
We doubled our position in Amazon after the price declined due to market worries regarding cost/wage inflation and the need for increased capital expenditure.

In contrast to many "covid beneficiaries," Amazon's sales are proving resilient, as the convenience of online shopping for everyday items has led to habit formation. To accommodate the increase in business, Amazon increased its operating square footage by 60% and 40% in 2020 and 2021. It plans to grow a further 25% in 2022.[6] Future revenues will benefit from this increase in capacity, and margins should expand as capital expenditure moderates. Furthermore, Amazon added ~75m Prime members in the 2020/21 2-year period, vs. ~50m in 2018/19. The value of these memberships is enormous, as each Prime member has a 98% 2-year retention rate and typically spends $2,500 per year on Amazon. Meanwhile, Amazon's 3rd party marketplace is an attractive high-margin business, and the company continues to ramp up advertising services to sellers on its platform.

With AWS and cloud services, Amazon and its peers (Google, Microsoft, etc.) provide the digital infrastructure for the modern economy. By some measures, the total addressable market is over $1.6 tr, which means AWS and its peers, large as they are, currently account for less than 7% of the market.[7] It is rare to have a company of the size and quality of Amazon with such significant long-term growth opportunities.

Trebia Acquisition Corp - redeemed
Trebia is a SPAC that announced the acquisition of System 1, an AdTech company. I did not have a strong opinion on the target business to justify holding and redeemed for $10/share. Overall, this was a 3% loss on a 2% position.

Exor
In 2021, Exor's Net Asset Value (NAV) per share grew 29.7%, with a 10-year compounded rate of 19.8%. Despite this, Exor trades at a large (~40%) discount to the value of its holdings.

Common arguments for large HoldCo discounts are that investors prefer to invest directly in the underlying equities as they do not trust HoldCo's capital allocation skills, and HoldCos rarely realize their assets' full value. In contrast, Exor has created billions of dollars of value for shareholders. From the spins of Ferrari and CNH out of Fiat in 2016 and 2013, respectively, to the spin of Iveco's "on-highway" business from CNH completed in Q1 2022, to the merger of Fiat itself with Peugeot to create Stellantis. The merger better positions both companies to rationalize car platforms to improve returns on investment and prepare for the transition to electric vehicles.

Exor will realize a $3.5bn gain (including dividends) on the sale of PartnerRe to Covéa later this year. Exor bought the business opportunistically in 2016. Under Exor's ownership, PartnerRe scaled its Health & Life insurance business to profitability, cut operating costs by 25%, grew PartnerRe's investment portfolio from $16.5bn to $20.5bn, improved investment returns, and developed a 3rd party asset management business with $1.1bn in AUM.[8]

Following the sale of ParterRe, despite an unexpected one-time payment of €746m (relating to the movement of its tax residence to Belgium), Exor will have over €8bn in cash to invest. We should benefit from NAV compounding for many years through Exor's intelligent deployment of capital into growing businesses, regardless of the discount.

KKR
KKR's share price was impacted by the general market and worries about interest rates, as Private Equity's business model relies on good exit multiples and leverage. Approximately 20% of KKR's portfolio is in public equities and is marked to market; for example, the 43% decline in Applovin cost KKR ~$3bn in value.

---

[6] Source Deutsche Bank report on Amazon dated March 10, 2022.
[7] ibid
[8] Exor 2021 letter to shareholders

Nevertheless, KKR's long-term performance driver remains the growth in its fee-paying assets under management (PFAUM), on which KKR earns both management and performance fees. So long as KKR continues to earn good returns for its investors, the growth in fees will continue to compound to KKR's benefit. Moreover, as 90% of PFAUM is perpetual or has a duration of over eight years, we have the rare advantage of good visibility into a key component of future performance.

Large managers, such as KKR, are highly diversified, have good track records, and receive the lion's share of industry AUM. KKR's capital recycling machine is in great shape. In 2021, KKR grew FPAUM 92% to $357 bn, deployed a staggering $73bn, and had gross unrealized carried interest of $8.6bn. In 2022, besides traditional private equity in the Americas and Europe, KKR will raise $13bn for five funds in Asia across infrastructure, real estate, credit, and growth. It will also raise $12bn for 5 "core" strategies, which are lower-risk assets that are more stable, less cyclical, and more cash-generative than those targeted by traditional private equity, and $15bn for ten real estate strategies. In March, it acquired Mitsubishi Corp.- UBS Realty Inc. with $15bn in AUM. As with other alternative managers, KKR is looking to grow its business with retail investors and insurance companies, both of which are underserved by alternatives and represent significant opportunities.

All the above gives me confidence in the company's 5-year target of doubling after-tax distributable earnings.

WANdisco

The good news is that WANdisco continues to announce some revenue wins with large enterprises. These have spanned several verticals (retail, telco, and insurance) and for multiple applications (IoT, machine learning, and analytics). The bad news is the contracts are small at only circa $1m, albeit with room to scale as these large enterprises migrate more of their data to the cloud. WANdisco needs to show a clear line of sight to $100m in recurring revenues to re-establish credibility with the market. At the current share price, the cost-benefit skews, in my view, to giving them a little more time, especially as they have shown themselves capable of winning deals across the major cloud platforms (Azure, AWS, Google, and Oracle).

Liberty Broadband – trim

We part-financed the additions to Amazon and Wayfair by trimming some Liberty Broadband. Liberty Broadband is a HoldCo and tracking stock whose primary holding is Charter Communications. Charter benefits from its extensive network of cable assets that can provide higher bandwidth internet at better prices than offerings from traditional telecom and satellite carriers. Moreover, with excellent management and capital stewardship, Charter has increased its high-margin broadband subscriber base despite losing some video subscribers to "cord-cutting."

Nevertheless, competition is intensifying, with telecom companies launching aggressive Fiber-To-The-Home upgrade plans and new entrants emerging with Fixed Wireless technologies.[9] Cable's co-axial lines are, for once, the inferior technology compared to FTTH. While Charter has many ways to upgrade its lines to remain competitive in the medium term, it no longer has a distinct advantage. As a result, in markets with fiber competition, cable companies typically have a 50% market share vs. the 80% market share they enjoy without fiber competition.

With Fixed Wireless, Cable has a strong advantage in owning the network for internet backhaul, but it is more difficult to predict the longer-term competitive environment. In both cases, moving from a near-monopoly to a duopoly, or longer-term an oligopoly, likely comes with weaker pricing power and slower subscriber growth. These considerations warranted trimming our Liberty Broadband position, and we will monitor developments closely.

[9] FTTH is when premises are connected directly to the network with fiber lines, instead of cable's older co-axial lines. Fixed Wireless is when a radio signal connects a premises or device to the network instead of a cable altogether.

Naspers
Naspers shares have come under a lot of pressure lately. The rout in internet company valuations has directly impacted its portfolio of companies. For example, Delivery Hero's stock declined 61% in the quarter. Additionally, Naspers decoupled from Avito in Russia and had to write down $700m for its holding in VK Group (formerly Mail.ru). Meanwhile, Tencent continues to be impacted by regulatory fears in China.

While regulation remains a critical risk, a meeting of China's top financial policy committee led by Vice Premier Liu He[10] called on regulators to "actively introduce policies that benefit markets" and indicated the worst of regulations might be over. Regulations have undeniably curtailed some of Tencent's growth, especially in its advertising and games businesses. Even so, the company still has solid fundamentals and attractive opportunities. For example, in gaming, Tencent has a network of 30 international studios with a global pipeline of 40+ games growing at 25% per year, not targeted by regulation in China. In business services, Tencent is investing in internet-as-a-service and platform-as-a-service products to capture the ample cloud opportunity in China.

Tencent's core business trades at 16x forward P/E, and the risks are priced in for what remains a very high-quality business. It is encouraging that management seems focused on capital allocation. Tencent has built a large and successful investment business, buying companies when they are private and seeing many of them progress to IPO. Tencent recently spun-out shares in JD.com, divested some of its stake in Sea Ltd. and indicated more could come.[11] Meanwhile, Naspers management is under increasing pressure to reduce the "unacceptable" ~$86bn discount and suggested it will take further steps to simplify its corporate structure.

<u>Portfolio – other changes</u>
This quarter we redeemed Trebia, trimmed Liberty Broadband, added to Amazon, and added to Wayfair.

Wayfair - add
In retrospect, I was too early with the initial investment in Wayfair. The price continued its decline in the first quarter as it became clear that the company could not sustain the revenue growth it achieved in 2020 when people spent more money on their homes during lockdowns. We used the volatility to buy more shares.

In prior years, Wayfair invested ahead of growth, and the company has historically been loss-making. However, as demonstrated in 2020, the existing infrastructure can handle increased volumes without a proportionate increase in costs, which will lead to improved unit economics as it fills its distribution capacity.

Wayfair's scale and substantial investments in logistics greatly simplify its suppliers' international shipping operations and often lower their international shipping costs, making Wayfair an attractive supplier partner. With 23,000 suppliers and an inventory-lite model, Wayfair offers consumers an unparalleled selection of 33m products and fast delivery due to its superior logistics. While it is tough to predict what will happen to revenues over the next quarter or 12 months, Wayfair's reinforcing marketplace dynamics should allow it to capture a large share of the growing online home goods market, leading to sales growth and profitability.

Samer Hakoura
Alphyn Capital Management, LLC
April 2022

---

[10] https://www.bloombergquint.com/global-economics/china-vows-to-keep-markets-stable-and-handle-developers-risks
[11] 2021 Q4 earnings call

Disclaimer

The description herein of the approach of Alphyn Capital Management, LLC and the targeted characteristics of its strategies and investments is based on current expectations and should not be considered definitive or a guarantee that the approaches, strategies, and investment portfolio will, in fact, possess these characteristics.

Reference or comparison to an index does not imply that the portfolio will be constructed in the same way as the index or achieve returns, volatility, or other results similar to the index. Unlike indices, the model portfolio will be actively managed and may include substantially fewer and different securities than those comprising each index. Results for the model portfolio as compared to the performance of the Standard & Poor's 500 Index (the "S&P 500") for informational purposes only. The S&P 500 is an unmanaged market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent US equity performance. The investment program does not mirror this index and the volatility may be materially different than the volatility of the S&P 500.

Performance results of the master portfolio are presented for information purposes only and reflect the impact that material economic and market factors had on the manager's decision-making process. No representation is being made that any investor or portfolio will or is likely to achieve profits or losses similar to those shown.

Results are net of all standard fees calculated at the highest rate charged, expenses and estimated incentive allocation. Model portfolio returns are inclusive of the reinvestment of dividends and other earnings, including income from new issues. The return is based on annual returns since inception and does not give effect to high water marks, if any. Returns may vary for investors who are restricted from participating in new issues.

Hypothetical performance results are unaudited and do not reflect actual results of any accounts managed by Alphyn Capital Management, LLC. Hypothetical performance results are for illustrative purposes only and are not necessarily indicative of performance that would have been actually achieved if an investment utilized the strategy during the relevant periods, nor are these simulations necessarily indicative of future performance of the strategy. Inherent limitations of hypothetical performance may include: 1) hypothetical results are generally prepared with the benefit of hindsight; 2) hypothetical results do not represent the impact that material economic and market factors might have on an investment adviser's decision-making process if the adviser were actually managing client money; 3) there are numerous factors related to the markets in general, many of which cannot be fully accounted for in the preparation of hypothetical performance results and all of which may adversely affect actual investment results.

There is no assurance that any of the securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and, in the aggregate, may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

The graphs, charts and other visual aids are provided for informational purposes only. None of these graphs, charts or visual aids can and of themselves be used to make investment decisions. No representation is made that these will assist any person in making investment decisions and no graph, chart or other visual aid can capture all factors and variables required in making such decisions.

This report is for informational purposes only and should not be construed as investment advice. It is not a recommendation of, or an offer to sell or solicitation of an offer to buy, any particular security, strategy or investment product. Our research for this report is based on current public information that we consider reliable, but we do not represent that the research or the report is accurate or complete, and it should not be relied on as such. Our views and opinions expressed in this report are current as of the date of this report and are subject to change. Any reproduction or other distribution of this material in whole or in part without the prior written consent of Alphyn Capital Management, LLC is prohibited.