

GOOD COMPANIES x BAD SECTORS = VALUE x OPPORTUNITY

HEDGE FUNDS (Inception)	MAY 2022	YEAR-TO-DATE	ANNUALIZED
Venator Founders Fund** (March 2006)	-4.9%	-29.7%	9.6%
Venator Select Fund (September 2013)	-14.9%	-42.2%	9.2%
S&P/TSX Total Return (March 2006)	0.1%	-1.3%	6.7%
Russell 2000 (March 2006)	0.2%	-16.6%	7.4%
S&P Toronto Small Cap (March 2006)	-2.3%	-0.9%	3.4%
S&P 500 (March 2006)	0.2%	-12.8%	9.7%

ALTERNATIVE MUTUAL FUNDS (Inception)	MAY 2022	YTD	1-YR	3-YR	5-YR	10-YR
Venator Alternative Income Fund*** (January 2020)	-1.8%	-10.0%	-8.7%	2.7%	3.5%	6.4%
B of A Merrill Lynch High Yield Index (August 2008)	0.2%	-7.8%	-5.0%	3.2%	3.4%	5.4%

* As of May 31, 2022

** Venator Founders Alternative Fund, which holds the same securities as Venator Founders Fund, is now available as a Liquid Alternative Mutual Fund; it is eligible to be held in both registered & non-registered accounts.

*** Performance data prior to January 24, 2020, relates to Class F Units of Venator Income Fund, which was distributed to investors on a prospectus-exempt basis in accordance with National Instrument 45-106

Our funds continued to lag in May, which served to add to our frustration as we move to the mid-point of the year. We use the word “frustration” because our companies have continued to push against the broader market narratives with materially improved business prospects vs where they were six months ago. Had we seen all of our companies’ press releases, been aware of the Russian-Ukrainian conflict, had advance copies of the Fed minutes and known that the S&P500/NASDAQ would be down 13-24%, we still would have thought we would have shown healthy gains at this point; that is how strong our companies financials have been (as noted below, these are not “beat by a penny, raise by a nickel results, these are substantial earnings beats by over 50% in some cases). We recently score-carded our companies’ earnings performance through two reported quarters this year (Q4 2021 and Q1 2022) and found that our 20 undebatable “beat-and-raise” companies cost us 18% this year, while our 8 indisputable “misses” cost us 6%; we also had a net loss of 7% on companies that we owned for shorter periods of time or where earnings couldn’t be classified as beats or misses based on stock behavior around quarterly announcements.

We would point out that, despite how it might look, we do not believe that we “overpaid” for our positions either. We are fully aware that improving fundamentals would provide no defense for a great growth company trading at absurd valuations seen towards the end of last year. We didn’t own technology companies above 20x sales (and wrote about the unsustainability of these valuations last year), we did not own EV/charging/battery startups, we did not own weed companies, we did not own crypto brokers or meme stocks, and we did not own companies sustaining massive losses, nor did we own companies that experienced disproportionate accelerated growth as a direct result of COVID (i.e., Zoom, Netflix, Chewy, Restoration Hardware). We thought that we had avoided all the growth traps and lowered expectations that have dragged down growth stocks this year, and the financial results of our companies have proven this out.

Unfortunately, the growth sector/tech crunch has hurt many of our companies despite strong results, often due to the gravitational pull of competitors and comparable that have been reporting weaker results. Our companies are being treated as though their relative financial strength is a function of being on “borrowed time” rather than superior fundamentals, despite strong growth histories that pre-date COVID. We present a brief synopsis of our five biggest “losers” this year, all of which we still own (each of these investments has cost us 2-3%):

- **Inotiv:** Inotiv is a “contract research outsourcer” for biotech/pharma specializing in preclinical discovery and safety. While the company has *materially* exceeded expectations, the stock has been hit hard by a competitor’s two earnings warnings with each warning successively taking Inotiv’s stock down 20% on the days of the warnings. Several members of Inotiv management had bought a substantial amount of stock prior to releasing its recent quarter which achieved revenue of \$140MM (vs \$120MM expected) and EBITDA of \$25MM (vs \$15MM expected). This sent the stock up from \$12.00 to \$16.00 which sounds like a lot until we note that the stock started the year at \$40.00! The company is currently undergoing several lab expansions to handle an extended backlog that runs out to next summer on the back of bookings exceeding billings by over 50%. We believe Inotiv can earn over \$2.00 within the next two years putting this secular grower well under 10x projected earnings per share.
- **RingCentral:** RingCentral is a stock we have owned on-and-off for years and repurchased at an average cost of \$150 *after* the stock had fallen from \$430. RingCentral software effectively replaces the hardware that runs a large company’s phone system and is the pioneer in this market. Unfortunately, it has the misfortune of being compared to Zoom (both companies have similar “messaging/video/phone” product offerings except Zoom leads with video and RingCentral leads with the replacement of outdated phone networks) and the charts have moved in lockstep through Zoom’s negative growth forecast revisions and despite RingCentral’s resilient upward growth revisions. However, we believe that the market is discounting some critical differences between the two companies (noting that sell-side has 24 buys to 2 holds for RingCentral, while the split on Zoom is 14 buys and 15 holds). RingCentral is a hardware-to-software replacement story, not a work-from-home play. Perhaps, the best point of differentiation is that RingCentral has, thus far, defied the “work from home beneficiary” thesis with their first quarter growth rate having held at 33% vs a pre-COVID growth rate of 34% and during COVID growth of 35%; this while none of its competitors (Zoom included) are expected to grow by more than 15% this year. It is worth noting that RingCentral’s revenue expectations for the current year have increased while Zoom has lowered their forecast by 7% to sub-15%. It is also worth noting that the CEO of RingCentral has recently instituted an automated personal share purchase plan, which is rare.
- **LoveSac Company:** We have profiled this furniture manufacturer in several of our last letters. This is a very focused and innovative retailer that was growing at 40% pre-COVID, 50% during COVID, and is still growing by 50% post-COVID (current 2022 guidance is for over 30% growth) - in contrast to other furniture retailers like Restoration Hardware (6% growth to 30% growth to 6% growth). While LoveSac stock has developed a habit of increasing 15%+ when it reports, it has also developed a trend of giving those gains back in the ensuing six weeks. In their most recent quarter, the company reported revenue of \$196MM (vs \$174 expected) and EPS of \$2.03 (vs \$0.54 expected). Earnings estimates for the current year have increased 50%! Currently trading at \$35.00, we believe this company will be earning over \$7.00 per share within the next several years while growing market share and expanding into adjacent markets with an incredibly loyal repeat customer base who buy enhancements to their existing furniture on a regular basis (extra sections on couches, new fabric upholstery that can be put on by the customer, integrated surround speaker system) which is a characteristic unique to LoveSac.
- **Uber Technologies:** One of our brand-name large caps, Uber is on the verge of tremendous free cash flow production. Uber guided earnings up midway through the first quarter, eventually topped that number and guided up for Q2. However, the quarter was overshadowed by a significant earnings warning by competitor Lyft a day earlier which cast a pall over Ubers’ stellar performance. With Ubers’ tax shields likely to last over 10 years, free cash flow per share should exceed \$2.50 within the next two years, making the stock exceedingly cheap at \$24.00 given a growth rate that is expected to exceed 20%. It is worth noting that Uber’s CEO has recently been buying shares personally.
- **Porch Group:** Porch Group provides software to the home inspection business and uses that comprehensive data set to gain a first mover advantage to market products and services to homebuyers (warranties, insurance, as well as lead management to trades, moving services and other services such as internet connectivity). It has also recently entered the insurance and warranty business directly through acquisitions and is providing superior “loss ratios” as a result of leveraging its proprietary inspection data when pricing these offerings. Porch has an unfortunate “trifecta” working against it: it is a former SPAC, it has convertible bonds outstanding, and has exposure to the real estate market. However, the opportunity in front of it is large and expansive, with many adjacencies to extend its market opportunities for years. With a current expectation for \$320MM in revenues this year (up from \$300MM six months ago), Porch Group

is hardly a speculative start-up. Porch's stock has reacted positively to each earnings report they have released but has experienced large drawdowns between quarters owing to the negative narrative qualities mentioned above. While Porch is one of the only companies in the portfolio that is losing money (it is a slightly seasonal business that was profitable in Q3 last year), the company trades at just over 1x sales which is exceedingly cheap for a company with its data "moat" and growth rate. We would also point out that the CEO has bought stock personally on several occasions this year.

It has been difficult to watch the price deterioration of these companies, but we believe that the value has increased and that these companies are exceeding expectations and lapping competitors for good reasons not appreciated by the market. We also believe that most of the companies in our portfolio are trading below 10x our expected 2023/24 earnings/free cash flow even when discounting a cloudy economic outlook. We are not holding these companies out of stubbornness (we have no problem cutting our losses in the face of expected fundamental deterioration or the uncovering of better opportunities); nor would we turn over the portfolio out of desperation. We look at a lot of businesses and believe that our holdings offer better potential than alternative opportunities we look at daily. Special companies have special qualities that allow them to excel during difficult times, while other companies are simply penalized or benefit from the economic backdrop of the current day; think of Lululemon or Aritzia being judged by their growth vs nearly every other lower growth apparel retailer that is just along for the ride during ebbs and flows of the broader economy. Our companies are demonstrating with each quarter that they are of the exceptional variety, and we believe that the market will recognize this as their growth rates and pricing power prove more durable than that of their competitors.

We continue to be bullish on the prospects of our Income Fund in an uncertain world for investment returns. Our yields of over 9% are as high as they have been in years. We believe the credit quality is strong, and the duration is short. Much of the weakness this year can be owed to our convertible positions. Their low coupons left them vulnerable to the rise in treasury rates as the embedded option value faded away with the stock market. We still own a few convertible securities that offer very compelling tax efficient returns and could convert before expiring several years from now. We would also point out that all of our positions are backed by public companies, which have more opportunities to refinance than private companies in times of stress.

From a broader macro perspective, there really are only two pieces of news out there right now: Inflation and Russian sanctions/energy. We still think that inflation will prove transitory. We realize that it is more popular to say that it is going to be a persistent problem, but we would remind people that only nine months ago the news cycle of "no inflation forever", "zero rates forever", "cryptocurrency is the new gold", "you can't pay enough for growth technology companies" and has a way of flip-flopping for clicks. We are already seeing weakness in the commentary of large retailers. Goods are starting to go on sale again as retail companies have over-ordered inventory. The growthiest companies are slowing hiring. Companies are slowing the pace of price increases as they meet consumer resistance. Home prices are plateauing, and rent can't be far behind. Industrial commodity prices are stable or falling. China appears to (finally) be reopening which will alleviate supply chain pressure. Semiconductor lead times are shrinking. Used auto prices are down. Most importantly, from a *practical* standpoint, the increase in the Fed funds rate may already be built into expectations. Long-term Treasuries are already reflecting a 3% rate as are mortgage rates at 5.25%. So even as the Fed makes its way to an eventual 2-3% rate, the practical rate might already be there.

The Russia-Ukraine situation is probably the one real wildcard here. No one knows how this ends. Neither side is willing to give up on the Donbas region, which speaks to a contained but drawn-out battle. Russia does not appear to be as hostile to Finland joining NATO as originally feared, which is a positive development from a broader regional perspective. Furthermore, the world appears to be making concessions in terms of trade when it comes to fertilizer and energy; this is of course out of necessity more than desire. Oil can be diverted as needed in a relatively expedient manner, but material liquified natural gas imports are years away from becoming reality. The clock is ticking for Europe to appease Putin by the winter, as he holds the key to creating a "heating tax" as bad as any economic sanctions currently impacting Russia; "if you don't want our oil, you can't have our gas" would be a very negative development for Europe.

Every day we come into the office thinking "how can we make money for our clients this month". Unfortunately, the answer is rarely "cash" (it is also rarely low growth defensive stocks trading at market multiples such as Walmart or utilities). There

are always going to be companies with durable growth, companies that are cheap, or some combination of the two (our favorite) and that is what we are hunting for. We believe that if you can't find 30 companies that you think will go up in the next 18 months out of an investible universe of over 10,000 companies then you simply aren't looking hard enough. This year, these opportunities seem to be concentrated in the energy sector, which we have been underinvested in since 2012. Our companies find themselves in secularly growing sectors where the market believes everything is hopeless. We are also in a period of historically low intra-sector dispersion, which means that, currently, sector selection matters and company selection does not after adjusting for beta. We believe that this situation will eventually end much as it did 20 years ago when the Oracles and Ciscos got left behind while the Salesforce.coms and Amazons emerged from the rubble.

We reserve the right to change our mind!



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