

May 3<sup>rd</sup>, 2022

**Dear Partners:**

I hope that you are doing well. As I write this, the portfolio's market value is roughly unchanged thus far in 2022 despite an environment in which both stocks and bonds have begun to experience substantial declines. The price to value ratio of our holdings is very attractive, below 60%. I was able to add a new investment to the portfolio, and am researching several other potentially attractive investments as the opportunity set has become more favorable for bargain-hunting. While value investing is always the right approach in my mind, the environment is becoming particularly favorable for this approach, and I am optimistic about our future prospects.

Partnership Performance			
	Last 12 Months	Last 3 Years (Annualized)	Since Inception (9/1/2016, Annualized)
Silver Ring Value Partners (Gross)*	-23.0%	16.1%	11.3%
Silver Ring Value Partners (Net)**	-19.8%	13.4%	9.2%
Average Cash Levels	3%	3%	17%
Average Option-Adjusted Net Exposure	63%	69%	64%
Russell 3000 Index	-3.1%	13.1%	13.7%
MSCI World Index	-3.1%	11.0%	11.5%

\*Gross results are before both the base and performance fees

\*\*Net results are net of all fees and expenses and use the 20% performance fee level above a 6% hurdle that represents the substantial majority of partnership assets over these periods

Partnership Results are audited through 12/31/2020 and unaudited afterwards

Most investors are too focused on reaching for the highest possible returns. Instead, you should start with safety first. Only when you have made sure that your capital is safe should you try to earn the highest returns that you can while limiting the probability of permanent capital loss.

As the market bubble is being dragged, kicking and screaming, to its deathbed the speculators and bull-market players are starting to get shell-shocked. Having thought themselves to be master stock pickers in an environment where the universe from which they were selecting investments had produced 25% annual returns, they are now staring at losses in the range of 25% to 50%, with likely more to come. Behaviorally, that is a very challenging situation in which to remain rational and make good investing decisions for the future.

Conversely, our safety-first disciplined value investing process that I outlined at the beginning of our journey in the [Owner's Manual](#) has kept us out of trouble. Now, as others are starting to panic and bargains are becoming more plentiful, I am calmly applying the process to finding investments that based on thorough analysis promise both safety of principal and a more than satisfactory return.

This is a good time to add capital to the partnership. Doing so isn't a decision to embrace overall equity valuations. We are invested in a concentrated portfolio of deeply undervalued investments and tail hedges, a number of which have idiosyncratic situations that may allow value to be unlocked even in a challenging market environment. Most of my family's capital is invested in the partnership, and I am as excited as I have ever been about the opportunities ahead.

## Executive Summary

At the end of April 2022 the portfolio was very attractively priced, with the Price to Base Case value ratio at 58%. The portfolio had 14 investments plus hedges, cash at 1% and option-adjusted net exposure at 16%. My investment decisions are driven by bottom-up considerations, and cash is a residual of that bottom-up investment process. I do not seek to time the market, and I continue to rigorously stick to my criteria for quality and discount to intrinsic value.

Portfolio Holdings			
Security		4/30/2022	4/30/2022
		% Portfolio	% Delta-Adjusted
1	WARNER BROS. DISCOVERY INC WBD US	5.3%	22.0%
2	OWENS-ILLINOIS INC OI US	14.0%	14.0%
3	FRESHII INC (previously Undisclosed Position #4) FRII CN	12.6%	12.6%
4	LIBERTY LATIN AMERICA LILAK US	12.0%	12.0%
5	Garrett Motion Position	10.8%	10.8%
6	AIMIA INC AIM CN	10.5%	10.5%
7	QURATE RETAIL INC-SERIES A QRTEA US	1.6%	8.5%
8	ALFA S.A.B ALFA MM	5.7%	5.7%
9	SPROUTS FARMERS MARKET INC SFM US	5.5%	5.5%
10	NAKED WINES PLC WINE LN	4.9%	4.9%
11	Equity Index Put Options	7.7%	-54.0%
12	Inflation Hedge (Put Options on TLT)	2.8%	-20.2%
13	Individual Equity Put Options (AAPL, TSLA, CMG, SNAP)	5.1%	-16.4%
All Investments		98.6%	15.9%
Cash & Equivalents		1.4%	

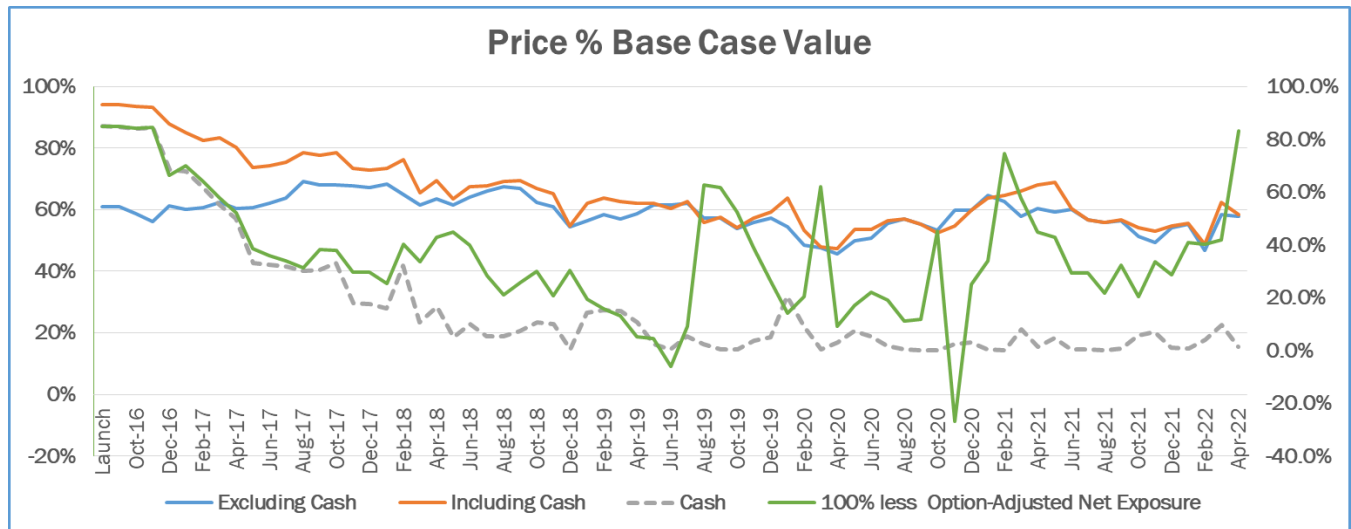
## Investment Activity

I made the following changes to the portfolio through the end of April 2022:

- **Increased** the Aimia (**AIM CN**) position from Small to Medium
- **Started** a **Small** position in Naked Wines (**WINE LN**)
- **Replaced** the equity component of the Warner Brothers Discovery (**WBD**) position (previously DISCK) with 2024 call options
- **Replaced** the equity component of the Qurate (**QRTEA**) position with 2023 call options
- **Exited** the PetMed Express (**PETS**) **put options** position
- **Exited** the Zoom Video (**ZM**) **put options** position

Investment Thesis Tracker																									
Ticker	Company Name	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	1Q 2020	2Q 2020	3Q 2020	4Q 2020	1Q 2021	2Q 2021	3Q 2021	4Q 2021	1Q 2022					
WBD US	WARNER BROS DISCOVERY INC																								
FRII CN	FRESHII					Start->																			
OI US	OWENS-ILLINOIS INC																								
LILAK US	LIBERTY LATIN AMERICA CL C																								
QRTEA US	QURATE RETAIL INC-SERIES A																								
AIM CN	AIMIA INC																								
SFM US	SPROUTS FARMERS MARKET INC																								
ALFAA MM	ALFA S.A.B.-A																								
GTX US	GARRETT MOTION INC																								
WINE LN	NAKED WINES PLC																								

- White: thesis is tracking roughly in-line with my base case
- Orange: thesis is tracking somewhat below my base case
- Red: thesis is tracking significantly below my base case
- Dull Green: thesis is tracking somewhat better than my base case
- Bright Green: thesis is tracking significantly better than my base case



- The portfolio was attractively priced at 58% of Base Case value at end of April
- Option-adjusted net exposure was at 16% at the end of the April, reflecting option-based hedges

### Operational Update

K-1s were delivered in mid-March as usual and are available on SS&C's portal. If you would like help accessing yours, please let me know.

## Portfolio Update

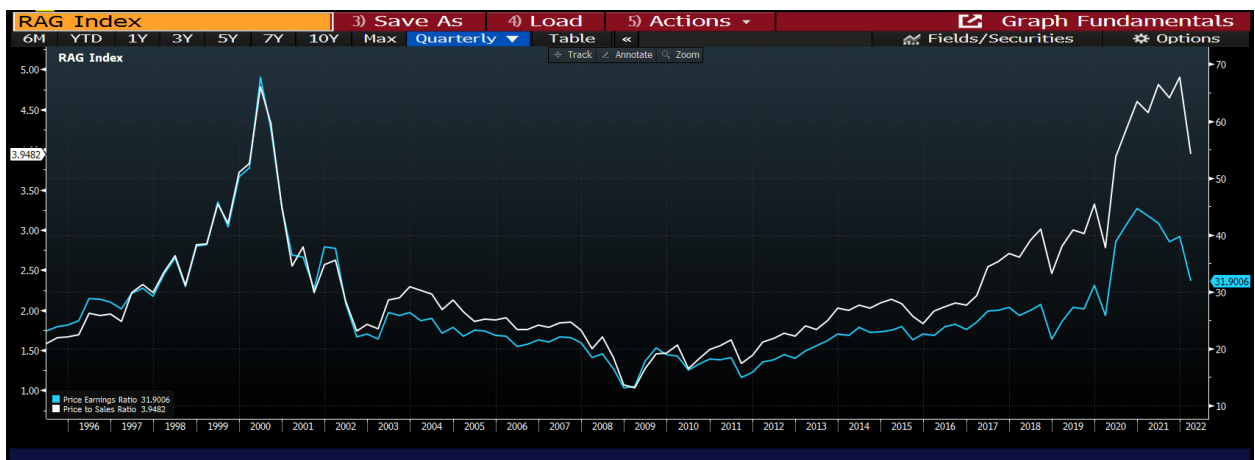
### Has The Demise Of The Growthsters Been Greatly Exaggerated?

I was shocked. A friend e-mailed me the news that a well-known growth manager had shut down. I didn't believe him. Just last summer I heard that manager self-promoting on the podcast circuit, trying to impress the audience with how sophisticated of a business-picker he was.

My friend was adamant that the news was true – he sent me an excerpt from the manager's letter to investors announcing the closure of the firm. I am, of course, not privy to any details other than what I read, and so it's totally possible that some personal issue led to the decision. However, the letter didn't refer to one. There is also a much simpler explanation: a quick look at the manager's portfolio reveals steep declines in prices for many of the holdings.

Another well-respected growth manager felt the need to provide a public early-March update. In it, he explained why the 20%+ decline in his portfolio year-to-date is completely irrational. A panic. Could it be because the stocks were overvalued at the start of the year? Nope, of course not. At least not according to the manager.

Well, I am no expert on this manager's portfolio and won't opine on it. However, at the risk of oversimplifying and painting with very broad brush strokes, let's take a look at the growthsters' hunting ground: the all-capitalization U.S. growth index, Russell 3000 Growth. I am sure I am missing many nuances, but why don't *you* be the judge of how likely it is that high growth stocks were overvalued at the start of 2022:



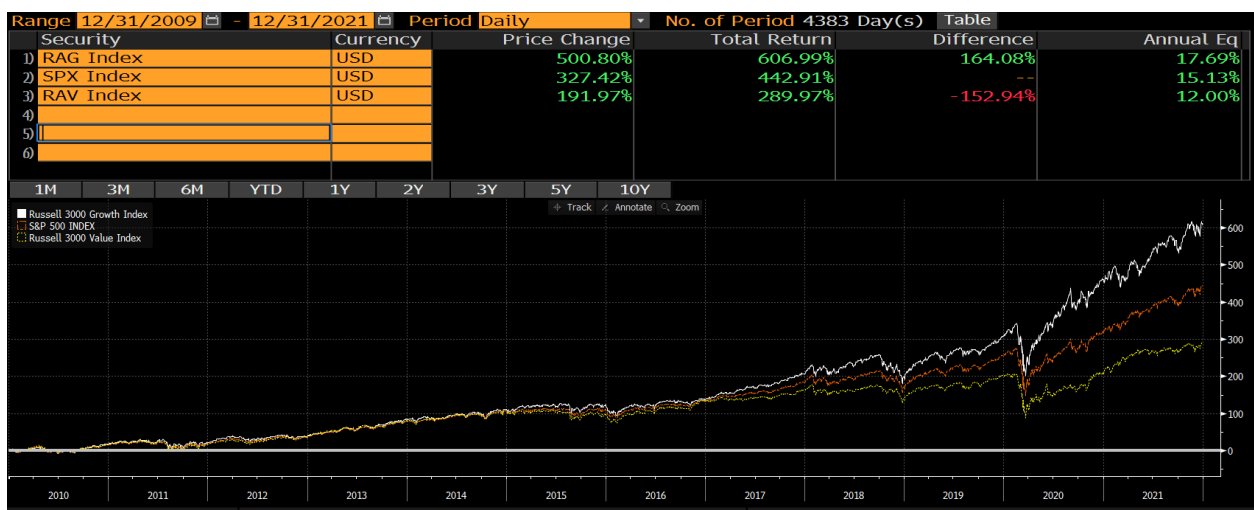
Source: Bloomberg

A third thoughtful growth investor complained about unfair happenings in China as the reason behind negative returns last year. I am [no expert on China](#), which is why I don't invest there. So forgive me for my ignorance, but isn't unfair happenings one of the main risks of investing there?

All of this begs the question: why are some of these growth managers making a big deal out of a relatively small sell-off over the course of a few months? Isn't the premise of being a long-term growth investor to focus on the businesses owned and not worry too much about the short-term stock price gyrations? Is it purely an attempt to calm the fraying nerves of clients, or is there also a component of trying to convince themselves that everything will be OK?

One possible explanation is that as a group, the growthsters had enjoyed a long and pleasant ride in the stock market. Along the way, they got to beat their chests publicly about the high quality and attractive growth prospects of the businesses that they owned. The sophistication of their research and analysis. Their ability to generate high returns despite the seemingly high valuation metrics of their stocks.

Consider that from 2010 through 2021, the Russell 3000 Growth, an all-cap U.S. growth index, has averaged almost 18% annual returns! This substantially outpaced the Russell 3000 Value index, an admittedly imperfect representation of the all-capitalization value universe. Over the 5 years ending in 2021, the annual returns for the Russell 3000 Growth were even higher: almost 25% vs. 11% for the Russell 3000 Value:



Source: Bloomberg

That's a lot of positive reinforcement from the market. Enough to instill a good amount of hubris if one isn't careful. After all, how can one resist believing that they are an amazing business analyst and investor if their companies report good news quarter after quarter, and the stocks keep going up higher and higher regardless of valuation?

The reality is that a monkey throwing darts at the high-growth stock universe would have generated amazing returns. Anyone who thinks that either 18% or 25% per year returns in a 2% inflation environment (ahhh, those were the days!) is normal or sustainable, simply hasn't studied market history. If some of those monkeys could talk, a few might be crafty enough to come up with a sophisticated narrative for why they are amazing dart throwers. Perhaps some such primates would

be able to raise large funds off of performance-chasing investors. Or even get invited to a few podcasts!

Let me be clear: I am not saying that all growth investors are lucky monkeys throwing darts. Far from it – I think there are a number of highly skilled growth investors (more on this later). What I am saying is that you didn't need to be highly skilled during this period to post phenomenal results. Nor to convince yourself or others that you are an amazing investor.

Put yourself in the growthsters' shoes. Faced with such monster returns, would you humbly announce to the world that you got lucky because of a massive liquidity and speculative fever-driven sentiment shift in the way the market prices your stocks? That in the absence of an enormous amount of government easy money and the gambling by many market participants that ensued that your returns would be considerably lower? That would be a rare person. Most would ascribe all or most of their results to skill and seek to benefit accordingly.

We have also heard a lot of condescending commentary in the last few years about more traditional value investors. They didn't get it. The market has changed, and they failed to change with it. New business models are here, and they are so powerful that old-fashioned [value investing just doesn't work](#). Or so some of the growthsters and many others said.

Now that perhaps the shoe is starting to be on the other foot, it would be tempting to say that all growth investing does not work or that those who succeeded using that approach just got lucky. That's not the case.

I know of a number of thoughtful, good growth investors. I am highly confident that they didn't just get lucky. Yes, the bubble of the last few years flattered their returns and made them look even better than they are. However, when we come out on the other side I believe that their skill will result in good or in some cases great long-term track records.

The problem is that for every such investor, there are many, many people who *did* just get lucky. The worst part? To most people, they look and sound just like the skillful growth investors. They publicly pontificate about their clever mental models. Their special research skills. And so on. They are really just self-promoters riding the wave and taking advantage of a period of favorable sentiment for the kind stocks that they traffic in.

Investing in high growth companies with little attention paid to valuations is a very difficult style of investing. By doing so, you are betting against base rate probabilities. Why? Because sustainable high growth is both very rare and very difficult to identify in advance. Besides, when practicing such a style high growth is not enough. The growth needs to be *higher* than that discounted in the stock price. And remember, those stock prices are set by many other smart investors.

So almost by definition, only a very small percentage of growth investors will beat the market. However, those who are uniquely skilled at this style are likely to have a much larger margin of victory than most other styles. In this lies the danger.

Newcomers to investing see the outcomes through the rose-colored glasses of [selection bias](#). They see the few spectacular successes of the growth investing approach and assume that they can do it too. Especially since this style of investing leans heavily on qualitative analysis. Phew, think the newcomers. No need to learn accounting or read the footnotes to the annual reports. They think that they can sit back in their arm chairs and translate their very high-level superficial business insights into excess returns. Most are very wrong, but you can see why it seems so tempting to try.

All of this makes it hard to figure out who is who. If the impostor growthsters have high returns and say similar-sounding sophistry to the real deal, how do you tell them apart? I don't have an easy answer. It's hard.

You would have to judge the quality of their decisions over a period of time, with that period including times when their style is out of favor. You do realize that *all* investing styles have periods, sometimes long ones, when they are out of favor, right?

That's asking way too much of most investors in funds, even those claiming to be sophisticated. Frequently their due diligence, if any, is just a fig leaf to mask jumping on some manager's high recent returns band wagon. And those among the growthsters who are particularly good at self-promotion take advantage of that to enrich themselves, usually at the expense of their clients in the long-term.

So is the recent sell-off in high growth stocks a short-term panic that will soon reverse? Where do things go from here? I don't know, and I suspect nobody really does either. I do believe it's likely that some really high quality companies have gotten oversold, and are starting to look interesting to a boring old "[value](#)" guy like me. At least that's where I am spending my time fishing for ideas, since my intrinsic value approach can be applied to high growth companies as well as to more mature ones. But only at the right price.

However, on the whole the markets and growth stocks overall are far from cheap. If history is any guide, there is a decent chance that the next few years will hold some more market pain for the growthsters. That's a good thing – it will help sort out the truly skilled ones from the pretenders. Once a bubble bursts, it's rare for the same one to get re-inflated for a while.



## Portfolio Activity

### Aimia (AIM CN)

The company entered into a binding agreement to sell its key asset, the 49% stake in AeroMexico's miles loyalty program (PLM). The price agreed was about a 10% haircut from the contractual price. That's the bad news. The good news is that this removes most of the downside tail risk.

The expected proceeds exceed the current market cap of the company. The plan is to use approximately 15% of the proceeds for share buybacks and the rest to buy 1 to 3 operating businesses. If done correctly, this should result in a recurring cash flow stream that comfortably exceeds the holding company fixed costs and preferred dividend payments.

I increased the position from Small to Medium because I believe the market is ignoring how the value range has changed relative to the market price. Whereas before there was some probability of large downside in a scenario where the company was somehow cheated out of its ownership of PLM, now that possibility appears to be off the table. For a slight reduction in the Base Case value (due to the slightly lower sales price), management has substantially increased the Worst Case value.

The current range of outcomes has no downside to the Worst Case value, and substantial expected return to the Base Case. What's more, this is now a very resilient, if not anti-fragile company which will be receiving a large amount of liquidity just as financial assets appear to be going on sale. In the hands of competent value investors, this should be a good opportunity for value creation.

### Naked Wines (WINE LN)

Naked Wines is a business with honest and competent management, a sustainable competitive advantage, a small share of a large addressable market, and a balance sheet with no debt and excess cash. Just last year, that description alone would fetch anywhere from 10x to 30x sales in terms of valuation for many a company. We purchased the shares for less than 15x normalized earnings and less than 40% of my Base Case value estimate.

The company operates a subscription wine club in the U.S., UK and Australia. Its business model has an *economies of networks*-based competitive advantage as it connects almost a million subscribers to 200+ boutique wine makers. It's a virtuous ecosystem where everybody benefits.

Small, skilled winemakers are able to find a path to market without worrying about marketing or cash flow. Since subscribers pay in advance, Naked Wines is able to pay the winemakers upfront and help them get the cash flow to get access to high quality grapes. As in many industries (including investment management), those with control of distribution aren't necessarily the best producers and the best producers aren't really skilled at distribution. Naked's model allows the winemakers to do what they love and get direct feedback from their customers.

What do subscribers get? They get a much lower price for a good product. Especially in the U.S., where the three tier distribution system results in a large mark-up, the discount that Naked is able to offer is substantial. Furthermore, subscribers are able to interact with the winemakers, provide feedback, and feel good about supporting small, independent producers who are pursuing their dream.

I have traveled to many wine regions of the world, so I consider myself to be a serious amateur as far as wine tasting is concerned. Prior to investing, I subscribed to Naked Wines and tasted their wines over the course of a month with my wife. There were no terrible wines, and the majority landed in the 7 out of 10 range for both of us. Considering that the average price was about \$15 and that we both had wines we had liked the same or even less in the \$100+ range, I think that this is a very good value proposition. I encourage you to try it out: [nakedwines.com](https://nakedwines.com)

Additionally, I have researched the company from the perspective of suppliers, competitors and former employees. Everything that I have come across so far validates the story and the company's competitive position. I was particularly impressed with the positive feedback for the CEO, Nick, from former employees. I was already impressed with Nick for his honest, humble and authentic communication style, and it was good to learn that people who no longer had a reason to sing his praises spoke highly of him.

Why does this opportunity exist? There are two reason. The first is that the market is in a mood to punish all of the former "COVID winners," of which Naked Wines was one. Many of them temporarily over-earned in 2020 and 2021, and the fear is that as the world re-opens that their results will revert to pre-COVID levels. While I am assuming a modest future decrease in sales due to the reversal of COVID benefits, I believe that a large portion of the gains is here to stay as customers who got exposed to the business model liked it and for the most part are deciding to stick with it. As partial evidence supporting this thesis, the company pre-announced results after I made the investment, and their subscriber count is up over the last 6 months.

The second reason is that the company doesn't screen as cheap. As a subscription business, it runs its subscriber acquisition costs through the income statement. This is equivalent to expensing growth investments which are going to produce cash flows for many years all at once in the current period. This creates the optics of a break-even business whereas in reality it's a very cash generative business that is reinvesting into growth at high incremental returns on capital.

So what caused me to make this a small position? First, there is meaningful downside to my Worst Case. Second, as with any young, growing company, there is execution risk. Finally, I would like to build additional confidence in my thesis over time, based on additional evidence and analysis prior to making it a bigger position.

### Warner Brothers Discovery (WBD)

Discovery completed the acquisition of the Warner Media business from AT&T in April, and the combined business is now named Warner Brothers Discovery. We are currently in the middle of an interesting technical event, following the spin-off special situation playbook.

The acquisition was structured as a spin-off of Warner Media, with AT&T shareholders receiving ~ 70% of the shares in the combined entity, or ~ 1.7B shares. Many of these shareholders owned AT&T for its phone business and its dividend. It appears that there has been elevated non-economic selling as these shareholders exit regardless of price. On the other side, few if any investors want to buy the WBD shares prior to this forced selling being over.

This has caused the stock to decline substantially despite being already priced at a low valuation and reporting good recent results. The people selling aren't likely considering either of those factors, which is what creates the opportunity. One wrinkle as compared to the usual spin-off special situation setup is that the non-economic selling is likely to last for some time given the retail nature of the shareholder base. This is different from the typical pattern where there is a quick sharp sell-off as institutional investors dump their shares quickly following the spin.

In anticipation of this situation, I had sold our equity prior to the major declines, and replaced it with January 2024 call options. I have since been using a portion of the cash generated from the equity sale to add to the option position as the stock price declines. While this does give up some time horizon, which I am usually loathe to do, both the technical selling and the question of the success of the merger integration are likely to be resolved well before then.

If I am correct and this is a much more valuable business than the market is giving it credit for, we will make a hefty profit. If I am wrong, and the combination of financial leverage, merger integration problems and secular risks are more serious than I foresee, we will have a moderate loss. I like our odds and the asymmetry of risk vs. reward.

### Qurate Retail (QRTEA)

Qurate pre-announced and then reported a weak Q4 2021 result that was below mine and the management's expectations. Specifically, organic sales declined 8% y/y overall, declined 7% y/y at the U.S. QxH business (main source of profits) and declined 5% y/y at the international QxH business. For perspective, my prior Base Case sales growth estimate was 0% over the long-term.

Whenever a company reports a weak result, the key question is always how that should inform our assumptions about the future. To do that, we need to understand the cause(s) of the results and then form an opinion about how these causes will shape future results for the company. In this case, I can think of five possible sources driving weaker than expected sales performance:

1. Secular decline/market share loss
2. Cyclical issues due tough comparisons vs. COVID-boosted prior year results

3. Supply chain issues affecting product availability
4. Internal execution/merchandizing issues
5. Fire at a major warehouse that impacted product availability towards the end of the quarter

Let's start with the cyclical issues first. If we look on a 2-year basis vs. Q4 2019, Q4 2021 overall annualized sales growth for Qurate was -1%, U.S. QxH sales declined at a 3% annualized rate and International QxH sales grew at a 2% annualized rate. Furthermore, it is possible that there was some sales pull-forward from 2021 into 2020 since people were forced to stay at home due to COVID and could have spent some of their future budget in that year. This would have had the effect of temporarily depressing the 2019 to 2021 2-year annualized growth rate into negative territory even in the absence of a structural decline in demand.

To be clear, I am not saying that all of the issues are cyclical, just that it's likely *a component* of the problem. Also, even if we don't assume that any of 2021's spend was pulled forward into 2020 and that the extra 2020 spend didn't lower the 2021 spend, a -3% annual decline rate certainly is less scary than the headline -8% as far as thinking about the future. Importantly, at U.S. QxH Q4 2020 growth was only +1% y/y, so the pull-forward argument doesn't fully account for the issues at the most important segment of the business. This points to the likelihood that there are issues other than just cyclical problems at hand.

The company was also impacted by supply chain issues, which limited availability of some of the merchandize. Electronics was one of the most impacted categories, which is also the category that is disproportionately favored by new customers. While neither I nor management can quantify exactly the impact from this cause, it was likely a material component of the problem. It will also likely persist for some number of quarters. However, it is not likely to be an issue over the long-term, so it is of less concern to us as far as trying to figure out what the current results imply about Qurate's future.

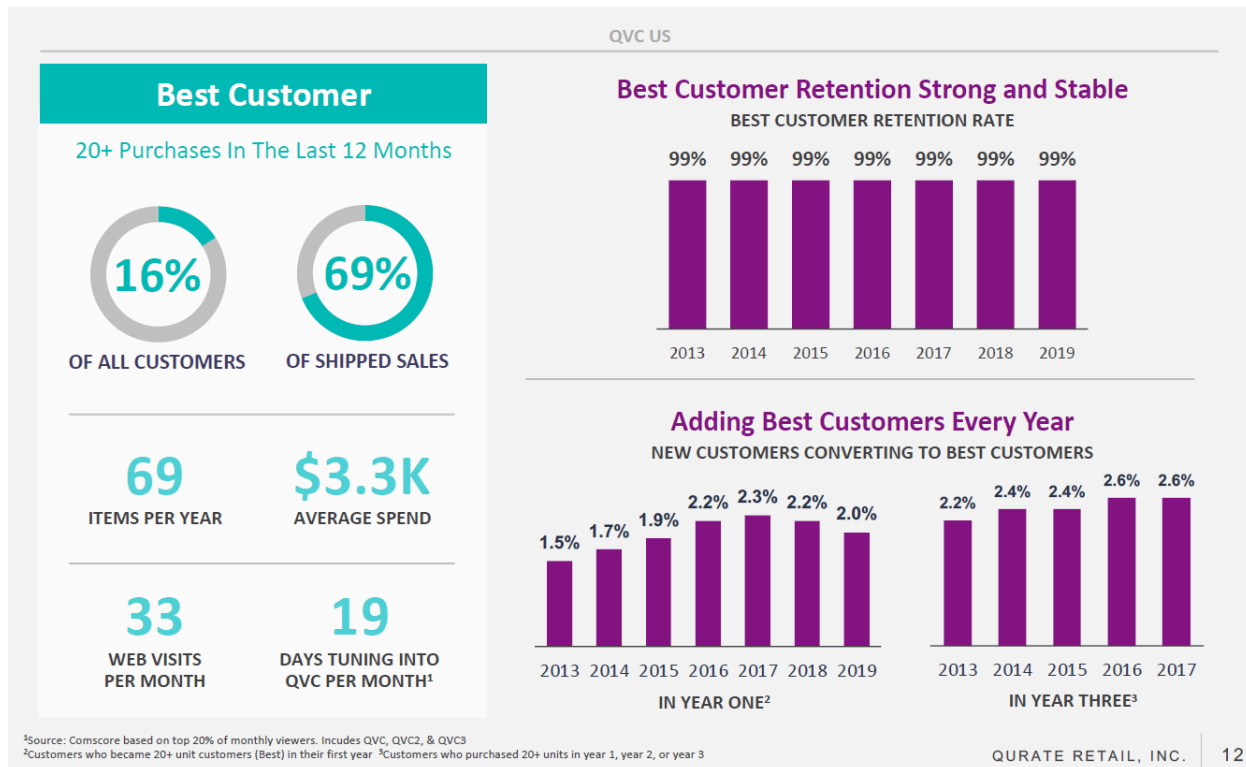
The fire at a warehouse which services ~ 20%-25% of demand occurred late in the quarter. It probably had a small impact, but not material enough to be a major driver.

Internal execution was also a likely issue. Management pointed to its matrix organization being ineffective in dealing with some of the challenges in real time. Since the quarter, several new senior management appointments were announced in the divisions. The good news is that self-inflicted issues can be fixed over time. The bad news is that they might not be fixed or might alienate customers while they are being fixed. So I would categorize these as medium-scary as far as understanding the impact on long-term results.

This leaves the secular/competitive issues. These are real, and likely accounted for some portion of the -3% annualized sales decline between Q4 2019 and Q4 2021 at U.S QxH. Management said that most cohorts of its "best customers," who account for over 2/3rds of sales, were unaffected but that they did see a small impact on the most recent cohorts of best customers. More clarity is needed on this issue, and it is something that I am watching carefully.

Coming back to “best customers,” they are a major reason for what gives this business a competitive advantage. Their habitual recurring purchases are a source of predictability for demand for Qurate. This recurring purchasing behavior has been there through the rise of Amazon, Facebook Marketplace, etc:

## Powered By Super Users



This does not mean that there is no risk – just because competition had failed to crack the code in the past, doesn’t mean that it won’t in the future. It does demonstrate an impressive level of resilience to competitive threats in the past that would be the envy of most retailers.

If we were to assume that the best customer behavior remains unchanged, we can perform a run-off valuation on this portion of the business. My estimate is that the best customers alone, net of all corporate costs and interest expense account for between 50c and \$1 in EPS. This assumes that very little needs to be spent on marketing to retain these customers, since they are already addicted to the service. Under these assumptions the run-off value of best customers would be over \$5/share, or in excess of where the stock is trading today.

As a result of the new information, my Base Case came down from ~ \$20 to ~ \$16. My new Base Case assumption is that Qurate is a business with normalized EPS/Free Cash Flow of ~ \$1.75/share that is declining in the low-single digits. This compares to the current price of around \$4.50.

I have sold the equity component of our Qurate position. Why? Because despite all of the above analysis I can be wrong about best customer behavior and competitive threats. If I am, and if the sales declines are much more substantial than I believe, then Qurate could be in trouble due to a combination of declining sales with fixed costs and high financial leverage. This is what risk management is all about – not betting everything on what one believes is most likely, but making sure that if the less likely but unfortunate outcome happens, that we avoid major permanent capital loss.

I have replaced the equity with a 2% position in 2023 call options. The incremental information between now and then should help me reassess how much of the problem is temporary vs. permanent. Given that the stock is at less than 30% of my Base Case value, this will allow us to meaningfully participate in the upside without risking a lot. The downside of this approach is that it shrinks the time horizon on this position. The upside is the large positive asymmetry in risk vs. reward given the ~ 30:1 odds that we are being given on the call options. I plan to monitor developments carefully and use the additional information between now and 2023 to decide the best path forward with this investment.

## Performance Discussion and Analysis

I encourage you to consider the results summarized below in conjunction with both the investment thesis tracker as well as the discussion of the individual companies in this letter. Any investment approach that is judged over less than a full economic and market cycle is liable to appear better than and worse than it really deserves at different points. Ultimately, it is the quality of the investment process and the discipline with which it is implemented that determines the long-term outcome. Therefore, I strongly encourage you to focus on process over outcome in the short-term.

Performance Analysis (4/30/2022)		
	Last 12 Months	Inception - 4/30/2022 (cumulative)
<b>Net Return (after all fees)*</b>	<b>-19.8%</b>	<b>64.8%</b>
Hurdle Rate of 6% per year	6.0%	39.1%
Russell 3000 (total return)	-3.1%	105.1%
MSCI World Index (total return)	-3.1%	83.9%
<b>Average Cash &amp; Equivalents % Portfolio</b>	<b>3%</b>	<b>17%</b>
<b>Average Option-Adjusted Net Exposure**</b>	<b>63%</b>	<b>64%</b>
<b>Contribution to Gross Return (before all fees)</b>		
Positions (including equities and options that were part of each position)		
Individual Equity Put Options	4.5%	-16.9%
Stock Market Put Option Hedges	1.3%	-1.9%
Sprouts Farmers Market	0.5%	0.3%
Inflation Hedge	0.5%	0.3%
Garrett Motion	0.2%	0.2%
Naked Wines	-0.1%	-0.1%
Aimia	-0.4%	0.3%
Alfa S.A.B.	-0.4%	0.0%
Charles & Colvard (previously Undisclosed Position 2)	-0.4%	19.7%
Owens-Illinois Inc	-1.9%	5.1%
Freshii (previously Undisclosed Position 4)	-4.7%	-5.4%
Liberty Latin America	-5.1%	-1.6%
Warner Bros. Discovery (previously Discovery Communications)	-6.6%	6.3%
Qurate Retail	-10.5%	22.1%
Covetrus Inc		23.3%
Mednax		1.6%
Carnival Corp Position		1.5%
Bristol-Myers Squibb CVR		-0.6%
Fox Corp		-0.2%
Arcadis NV		4.5%
eBay Inc		3.0%
Berkshire Hathaway		0.2%
Medifast		1.1%
Gilead Sciences Position		1.1%
Caesars Entertainment		1.1%
Allergan Plc		6.1%
Care.com (previously Undisclosed Position 5)		1.7%
American Tower Position		3.7%
Cimpress NV		2.2%
Hill International (previously Undisclosed Position 3)		1.1%
Go-Ahead Group		0.4%
CommerceHub Inc		1.4%
Innoviva (previously Undisclosed Position 1)		2.0%

\* Performance fee is presented based on the 20% rate, which reflected the majority of the assets during these time periods

\*\* Option-Adjusted Net Exposure adjusts for the use of options by replacing their weight with the delta-adjusted notional value for each option. While imperfect, it takes into account both the use of put option hedges and the presence of call options

Disclaimers: Please see the "Disclaimers" section at the end of this letter



## Your Questions

As I have committed to do in the Owner's Manual, I will use these letters to provide answers to questions that I receive when I believe the answers to be of interest to all of the partners. This quarter I received one question that I thought would be helpful to address in this letter. (Please keep the questions coming; I will do my best to address them fully.)

### **Are the hedges meant to reduce volatility or to be profitable on their own? How do you estimate the expected return on the hedges?**

The hedges are definitely *not* meant to reduce mark-to-market volatility in the short term. They are meant to be profitable on their own, on an expected value basis. This means that in some branches that the future might take, they will be very profitable, and in others they will just be a cost. It is my judgement of the probabilities that in the current situation the odds of extreme events are much higher than the odds implied by the price of the hedges.

How can I know the probabilities? I cannot know them precisely or derive them using some formula. However, that's no different than many other judgements under uncertainty that I must make as an investor when estimating the likely path for companies' fundamentals underpinning my value estimates. Those cannot be precisely nor formulaically estimated either.

What factors do I use to come to the conclusion that the probability of extreme events in the markets is elevated? The following, taken together, is what makes me particularly concerned about this environment:

- Very high valuations
- Low availability of deeply undervalued securities
- Loose credit and (up until very recently) historically and artificially low long-term interest rates
- Widespread gambling in financial markets by retail and institutional investors
- Bubble-like behavior in pockets of the market including portions of the equity markets as well as many crypto-related "assets"

If you consider a typical cycle, I might use hedges in a one or two years, or maybe not at all. In my view, this has not been a typical top of the cycle, but a once-in-a-generation confluence of events leading to extreme market behavior. We have seen similar behavior in the late 1920s, late 1960s and late 1990s. I would argue that the environment is much more dangerous than in 2006-2007 when only a specific sector was overextended and there was not the same wide-spread manic greed as we have seen in the last few years.

So you shouldn't take the annual cost of the hedges over the last few years and assume that this is an ongoing cost. Or even that it is likely to be a cost repeated every 5 to 10 years. While I will use my best judgement in the future, it is quite possible that there will be decades with no hedges at all.



It is also important to appreciate two indirect benefits of the hedges other than their express payoff odds. First, in an environment where the hedges produce a large payoff, the proceeds will likely to be redeployed in very undervalued securities. Perhaps as undervalued as 30% to 50% of my Base Case value estimate. That will magnify the long-term benefit of any payoff substantially.

The second benefit is behavioral. I pride myself on my temperament, and on my ability to make rational decisions under pressure. However, everyone is human. I don't know of a single investor who would not be at least somewhat impacted by huge market losses. While they might tell others, or even themselves, that they are not, that is unlikely to be true. We own a small group of mostly off-the-beaten path securities. In a deep, multi-year market selloff of the variety that has followed some past periods of wild excess, that group might be temporarily marked down substantially. That doesn't mean that their long-term value will necessarily be impaired, but in that kind of market nobody will care too much about how cheap something is, especially for smaller and less well known companies. Having an influx of cash from the hedges on the order of 20% to 30% can cushion that blow and allow the peace of mind to make higher quality decisions when they will count most.

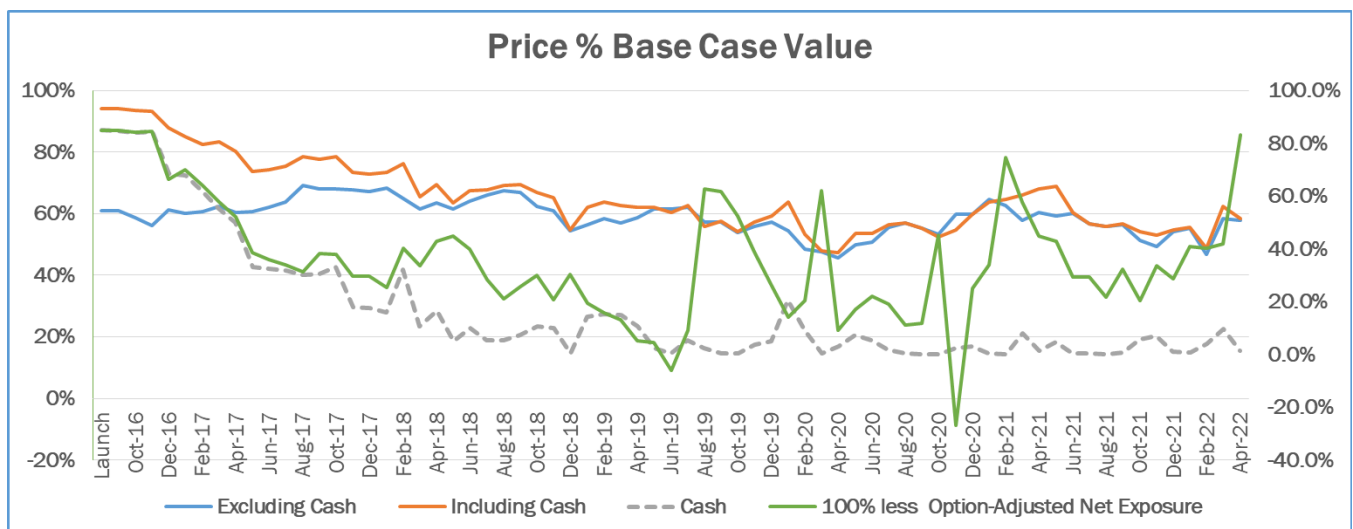
I have always been upfront that I invest with a safety-first mindset. That has a cost. I believe that over the long term it is very much worth it to approach investing that way, but during a market upswing the cost creates a drag that expresses itself in performance that lags the market. I am comfortable with that trade-off because I believe it is part of what should allow us to achieve substantially superior results over the long-term. Oh, and sleeping well at night regardless of what you hear on the news or see in the market, for everyone involved, is worth something too.

## Portfolio Metrics

I track a number of metrics for the portfolio to help me better understand it and manage risk. I track these both at a given point in time, and as a time series to analyze how the portfolio has changed over time to make sure that it is invested in the way that I intend for it to be. Below I share a number of these metrics, what each means, and what it can tell us about the portfolio. As time passes, you should be able to refer to these charts and graphs to help you gain deeper insight into how I am applying my process.

### Price % Base Case Value

This metric tracks the portfolio's weighted average ratio between market price and my Base Case intrinsic value estimate of each security. This ratio is presented both including cash and equivalents, which are valued at a Price to Value of 100%, and excluding those. All else being equal, the lower these numbers are, the better. Excluding cash and equivalents, a level above 100% would be a red flag, indicating that the portfolio is trading above my estimate of intrinsic value. Levels between 90% and 100% I would characterize as a yellow flag, suggesting that the portfolio is very close to my estimate of value. Levels between 75% and 90% are lukewarm, while levels below 75% are attractive.



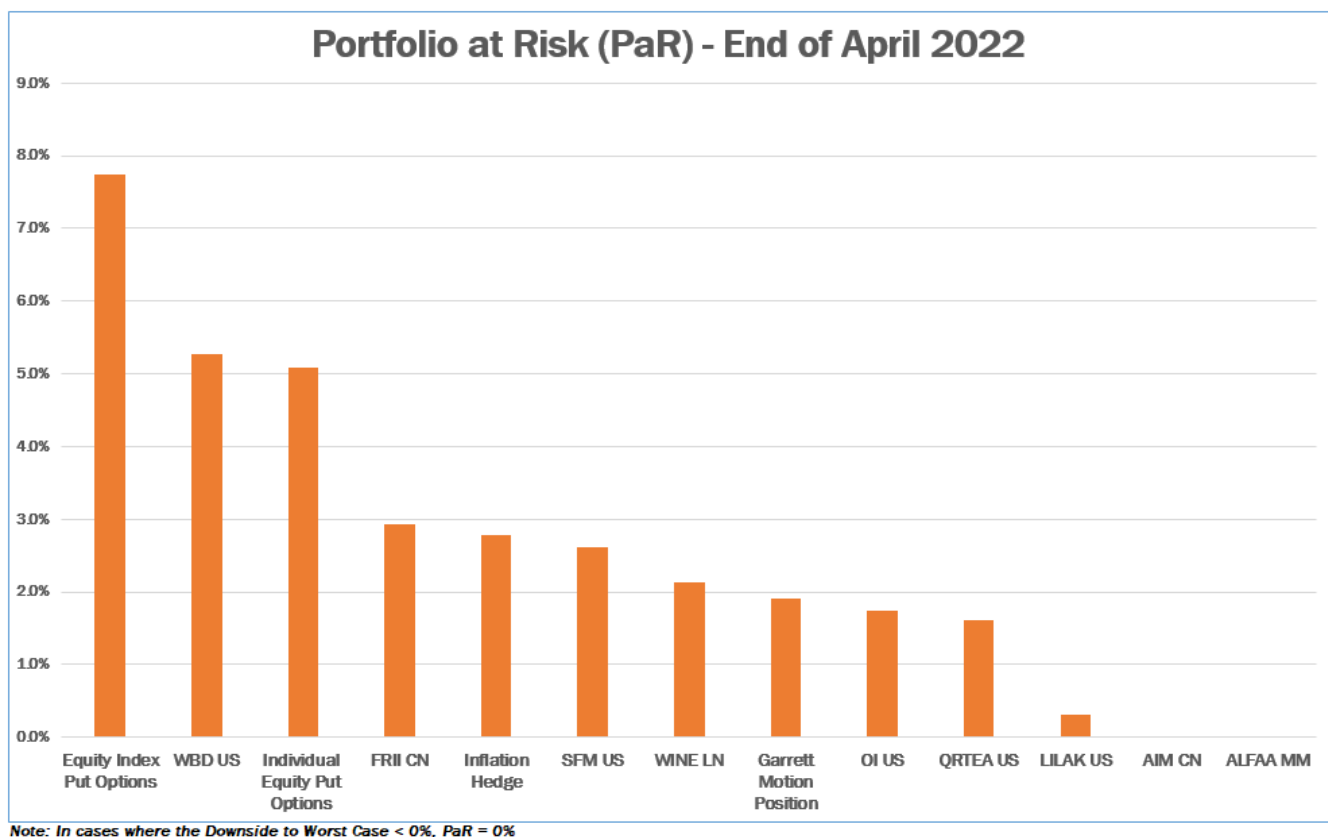
## Quality Quintiles

As outlined in the Owner's Manual, I evaluate the quality of the Business, the Management and the Balance Sheet as part of my assessment of each company. I grade each on a 5-point scale with 1 meaning Excellent, 2 Above Average, 3 Average, 4 Below Average and 5 Terrible. The chart that follows presents the weighted average for each of the three metrics for the securities in the portfolio.



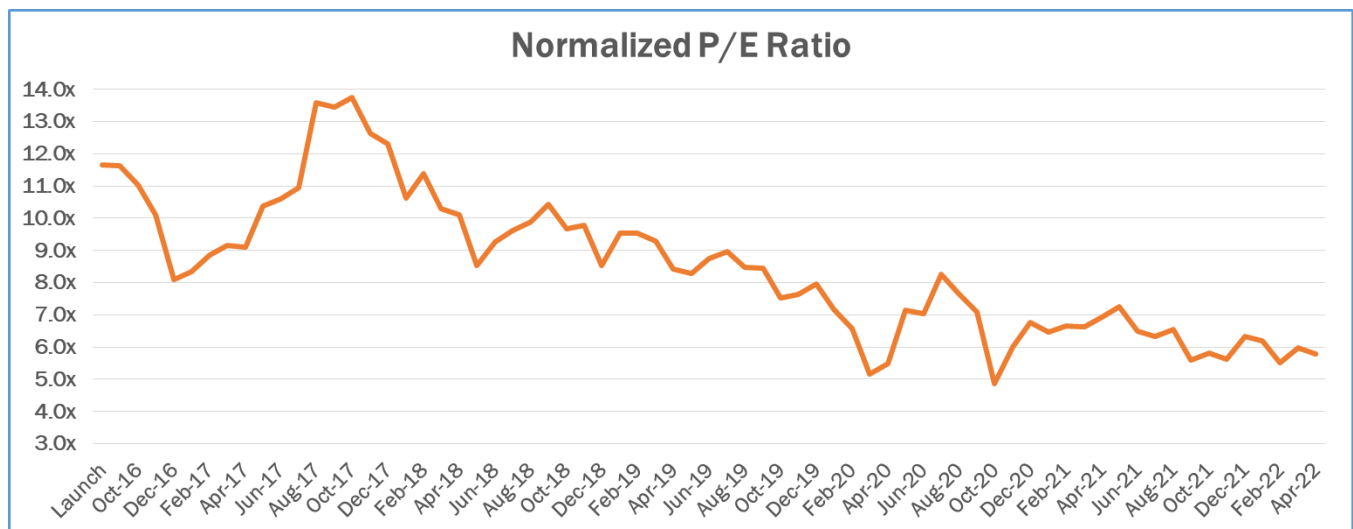
## Portfolio at Risk (PaR)

I estimate the Portfolio at Risk (PaR) of each position by multiplying the weight of each position in the portfolio by the percent downside from the current price to the Worst Case estimate of intrinsic value. This helps me manage the risk of permanent capital loss and size positions appropriately, so that no single security can cause such a material permanent capital loss that the rest of the portfolio, at reasonable rates of return, would not be able to overcome. I typically size positions at purchase to have PaR levels of 5% or lower, and a PaR value of 10% or more at any time would be a red flag. The chart below depicts the PaR values for the securities in the portfolio as of the end of the quarter. Positions are presented including options when applicable.



## Normalized Price-to-Earnings (P/E) Ratio

I supplement my intrinsic value estimates, which are based on Discounted Cash Flow (DCF) analysis, with a number of other metrics that I use to make sure that my value estimates make sense. One of the more useful ones is the Normalized P/E ratio. The denominator is my estimate of earnings over the next 12 months, adjusted for any one-time/unsustainable factors, and if necessary adjusted for the cyclical nature of the business to reflect a mid-cycle economic environment. The numerator is adjusted for any excess assets (e.g. excess cash) not used to generate my estimate of normalized earnings. One way to interpret this number is that its inverse represents the rate of return we would receive on our purchase price if earnings remained permanently flat. So a normalized P/E of 10x would be consistent with an expectation of a 10% return. While the future is uncertain, it is typically my goal to invest in businesses whose value is increasing over time. If I am correct in my analysis, our return should exceed the inverse of the normalized P/E ratio over a long period of time. The graph below represents the weighted average normalized P/E for the equities in the portfolio.



## Conclusion

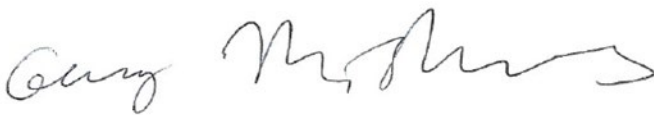
The real distinction isn't between "Growth Investing" and "Value Investing." The difference is between "Intrinsic Value Investing" and "Greater Fool Investing."

There are "value investors" playing the greater-fool game: "If this company earns N in this quarter/year the market will value it at  $Y \times N$  and I will get out, regardless of what the business is really worth." There are "growth investors" playing the greater-fool game: "If this company raises/beats guidance or forecasts a higher long-term growth rate, the market will extrapolate that and the stock will go up, and I can make money regardless of whether it comes true or not."

The Greater Fool Investors only care about what someone else will pay for an asset, regardless of its cash flows. The Intrinsic Value Investors care about the long-term cash flow stream and its present value, not how the market will price it at a specific point in time.

I am happy to answer any questions you have. Your feedback is important to me; please let me know how I can improve future letters. I greatly appreciate your trust and support, and I continue to work diligently to invest our capital. I wish you and your family a healthy, happy and prosperous New Year!

Sincerely,



Gary Mishuris, CFA  
Managing Partner, Chief Investment Officer  
Silver Ring Value Partners Limited Partnership

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