

Fairlight Alpha Fund LP

Q2 2024 Letter

Dear Partners,

Fairlight Alpha Fund's second quarter 2024 returns were 14.6% net of fees. This compares to 4.3% for the S&P 500 Total Return index. Overall, since inception the fund has returned 598.2% net of fees and 43.9% on an annualized basis.

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 2019-2023, followed by the compounded returns over the same period, as well as the annualized gains.

Annual Returns

<u>Year</u>	<u>Fairlight Alpha Fund</u>	<u>S&P 500 (Total Return)</u>	<u>Difference</u>
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%
2023	6.9%	26.3%	-19.4%
2024 (YTD)	31.2%	15.3%	15.9%

Compounded Returns

<u>Year</u>	<u>Fairlight Alpha Fund</u>	<u>S&P 500 (Total Return)</u>	<u>Difference</u>
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%
2023	432.2%	85.9%	346.4%
2024 (YTD)	598.2%	114.3%	483.9%
Annualized Gain	43.9%	15.3%	28.6%

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

- (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.

The fund exceeded the positive return for the S&P 500 (Total Return) for the first and second quarters this year. There will always be periods of market volatility, but over time we aim to achieve a return in excess of the general market. During periods where general prices of stocks retreat we will work hard to rotate the portfolio where we can to create long-term compounded returns.

Market and Portfolio Performance

The first half of the year was very positive for the fund and has been positive for many small cap investors, particularly for certain names that have had exceptional performance. Many of these were initially far too cheap to their true value, particularly when factoring in business growth. But through the first half of the year some storm clouds have been gathering and were actually there all the time with hindsight.

Geopolitical uncertainty has remained high, but the market appeared to shrug off what might have scared investors at other points in time. As of the time of writing it appears that market fears are rising and there may be a small or larger correction. As ever we don't try and predict what will happen with the general level of prices or indexes. We constantly try to analyze in the opposite direction, look at businesses from the bottom up, their financials and valuations and compare them to the prices that are presented to us each day, even when these are varying more rapidly.

Expertise in Business

By the late 1970s Anders Ericsson (1947-2020), a Swedish psychologist and Professor of Psychology at Florida State University had become internationally recognized for his research into expertise. He performed a variety of experiments, including an early intriguing experiment where he recruited an undergraduate student (a student and track athlete) for multiple, one-hour sessions to listen to a sequence of number spoken out loud at approximately one-second intervals, recall them and repeat them back. If the student was successful he was then given a sequence of numbers one digit longer than previously. If he failed then Anders would take off two digits. This process kept the student at or near his ability to recall number sequences for the whole session.

This process was repeated over many, many one-hour sessions. Later, in 1979 the student Steve Faloon became the world record holder for memory recall of long-digit number sequences, having reached more than 80 digits.²

How did he do this? Partly this was due to the length of time he put (or was put through) into the practice of recalling number sequences. Through multiple one-hour sessions each week and overall hundreds of hours of practice he increased his level of recall and performance. And this occurred in a perhaps unexpected way, with the increases occurring in a series of "jumps" where his recall reached a higher plateau and stayed there. At one point, he began to compartmentalize groups of numbers and jumped from a not exceptional recall of 7-8 digits to a more unusual 20 digits. Later, he and others used various other techniques such as linking digits to long-term memories.

² For more information see: "Peak", by Anders Ericsson and Robert Pool, 2016.

The additional insight that Anders gave us into expertise can be helpful in various ways. Apart from understanding that effort over a long period of time is helpful (the often quoted, but fallacious 10,000-hour rule is one example taken from Anders Ericsson's work by Malcolm Gladwell), it shows that expertise is gained by repetition, but also particularly by "deliberate practice". This type of practice is more systematic, focusing on areas of weakness, but also guided by mentors, coaches or other experts.

There are, of course, many experts in the field of investing. But the above understanding and framework can be helpful when evaluating company management, CEOs and research teams. Many outstanding companies have highly skilled professionals who have honed their expertise over many years in both company management and the technical fields in which the company operates. Several companies mentioned in the letter and prior letters are good examples of this kind of management and technical expertise.

A Review of Some Specific Ideas

Even with the markets having increased over the last six months, and with many having increased by double-digit returns, there are still a lot of interesting ideas that exist across many markets and many sectors. We aim to look for attractive valuations, growing businesses with quality elements that will protect the business and the future growth for many years. This comes in various forms across markets, from technical IP, patents, embedded position in local markets, unique business offering or early-mover advantage.

We also see the continuing evolution of intelligent technologies, machine learning and AI. At a macro level it is hard to see where in the Gartner Hype Cycle we are with each type or sub-type of technology. Machine learning and simpler forms of AI have been around for decades, but there have been a series of technical improvements that have spawned the current seeming step-change in AI technologies. Advances in backpropagation, transformers, BERT³ and self-attention mechanisms passed most of us by over the last few years, but are all key components of Large Language Models (LLMs) like GPT and Claude and have helped create the current level of performance of AI models. But we do also see some talk about the lack of use cases and difficulties around the black box nature of these models.

As we have discussed before this is directly or indirectly impacting many businesses and even seemingly unrelated areas of business.

Also, the economic picture is mixed and complex. Rates are projected to fall, inflation has come down and some measures are showing that the US may have already entered a recession. We think it is best for us to not try to predict the future of macro changes, which over the long term become harder and harder to predict. Instead we approach investments on a bottom-up basis and look for great companies, that are on sale or cheap, and with understandable businesses that appear to us after analysis to have strong fundamentals that will continue into the future.

There are some names we have recently analyzed, but cannot discuss yet that have particular business characteristics that will benefit them irrespective of the above large scale changes in the world economy and outlook. One is a technology company benefitting from the ability of technology companies, particularly in software or services, that are able to sell across borders and across the world. This gives them many benefits such as being able to domicile or locate operations in lower

³ These technicalities aren't relevant for most investors, but in high-level terms these are techniques to improve how models solve, process language information in parallel, and weight the importance of words.

cost jurisdictions and then sell into higher margin areas. This particular name has also recently gone through a business inflection of the type we look for.

There are other businesses that are seeking to exploit new technologies at varying levels of maturity. Some can't be large positions yet, or are too immature to invest in for us. But others are starting to show promising financial results and so we will build on them as and when they grow. It's worth noting that although AI may be the latest buzzword, there are many other unrelated technologies that are also advancing. We think Scotty would be proud!

Waterworld

This is a reference not to the movie where almost the entire surface of the earth is covered in water, but current day earth where *only* 71% of the earth is covered in water. Even on land there is water not far under the surface, in aquifers, or around us in lakes, rivers and seas. If you dig down, soon you will hit water or be digging close to a source of water.

After reviewing many thousands of businesses around the globe it is striking how many are miners, or operate in related areas to mining, extracting, refining, processing the raw materials for many of the objects we use in everyday life or for other industrial processes. This mining activity can intersect aquifers, leaching harmful materials into the water, surface water runoff, tailings and waster rock can also leach into local water causing contamination if not properly managed. One company that is tackling this very large problem is BQE Water Inc. (\$BQE.V).

The company has a variety of technologies that it uses to reduce contaminants from mining activities, achieving very low contaminant concentrations. There are increasing regulations regarding water purity and concentration limits, and the industry as a whole is significantly lagging behind where it needs to be, which puts BQE in a very strong position. Historically, even water dilution has been used as a method of "cleaning" water, which achieves no net benefit to contaminated water levels.

A key technology for this company is Selen-IX™ which efficiently removes selenium from wastewater. This is a new physico-chemical⁴ process, which unlike previous biological treatment systems makes it insensitive to water temperature and works with varying water flows and contaminant concentrations. This has been implemented at several mining sites and can remove selenium concentrations to less than 2 parts per billion. The ability of this process to handle very large volumes allows it to process water for environmental discharge, ensuring that the output has very low impurity concentrations.

They also have other technologies, some patented. These include metal treatment using ion exchange (Met-IX™), sulphate treatment (Sulf-IX™ and Sulf-IXC™) to remove sulphate from hard water waste streams, and cyanide/SART (Sulphidization-Acidification-Recycling-Thickening) removal from gold ore. This latter process allows recovery of metals like copper to be sold as a by product from gold mines, waste reduction and enhances gold recovery.

Apart from these technicalities the business itself has some great characteristics. There is typically a test phase or technical services phase, which the company hopes then leads into an operational phase. This later phase could be many years or decades depending on the type of mine. Margins are higher in this phase and are recurring, with a significant level of switching cost lock-in, as can be imagined. Attempting to switch providers at any stage during the operational phase would be extremely expensive. As well as the potential for an increasing stream of locked-in, recurring revenues there are

⁴ For those who are more expert than us in chemical and industrial processes the Selen-IX™ process uses ion exchange to remove selenium ions and electro-reduction to transform selenium into solid form.

also some projects which the company has referred to as “company-maker” projects. These would be much larger nature, relating to large mines with long mine lives.

We purchased at less than 2x our estimate of NTM revenues. And this doesn’t take into account the fact that a mining project has recently been approved that is likely one of those listed as a company-maker by BQE. The Market didn’t react to this news and in fact the stock has recently fallen with some of the negative sentiment over the last few weeks. A frequent reminder that there is often more than one opportunity to enter a great position.

And Finally

The future is uncertain, but that can be a good thing.” — Jennifer Niven.

Thank you for reading these letters. We are always pleased to hear from anyone that wants to reach out to us or discuss ideas. And anyone who would like to leave the worry of market volatility, or those who lack the time to manage their own investments, please reach out to us to find out more.

Yours,

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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.