

January 18, 2024

Dear Partner:

Arquitos returned 22.1% net of fees in 2023. Please see page six for more detailed performance information.

One of the things I look for in a company is skin in the game. I want the decision makers to have a material ownership stake. Enough where their decisions matter. Decision makers can be in different positions in different companies. Sometimes it is the CEO. Sometimes an activist. Sometimes one or more members of the board. Wherever they happen to be, I want to know that they have a stake in the outcome.

As Nassim Taleb wrote in *Antifragile*:

“First, never get on a plane if the pilot is not on board...

The first heuristic addresses the asymmetry in rewards and punishment, or transfer of fragility between individuals. Ralph Nader has a simple rule: people voting for war need to have at least one descendant (child or grandchild) exposed to combat. For the Romans, engineers needed to spend some time under the bridge they built – something that should be required of financial engineers today. The English went further and had the families of the engineers spend time with them under the bridge after it was built.”

Ownership doesn't guarantee success, but it focuses the decision maker. It can also provide a signal, a clue about what is happening behind the scenes, and we'll take every clue we can get.

Our big five positions heading into 2024 are Liquidia, Vistry, Lifecore, ENDI, and Nam Tai. Each of these companies, in their own way, has some skin in the game element.

### **Liquidia**

We ended the year strong due to great news from Liquidia. The company won its patent litigation appeal against United Therapeutics. Shares ran up 68% in December and have continued to climb in the new year. It is my favorite position, and I expect much more ahead.

CEO Roger Jeffs made a \$1 million share purchase in mid-December, right before the judicial decision came down. Clearly, he believed the result would be positive. In total, he owns more than \$30 million of Liquidia shares.

Jeffs was previously the driving force behind Liquidia's competitor, retiring as co-CEO of United Therapeutics in 2016 after an 18 year tenure. He understands the Pulmonary Arterial Hypertension (PAH) market better than anyone else, and he is highly optimistic about the company and its prospects to take significant market share from United Therapeutics.

The legal hurdles are nearly over. Liquidia is expected to have its Yutrepia inhaler product on the market in April. They have built out their sales force over the last year and have been meeting with doctors since October.

The company recently presented at the JP Morgan health care conference, reiterating the superiority of their product. Liquidia has a patented manufacturing process that allows for enhanced delivery of Yutrepia to the deep lung. Clinical trials have shown that compared to the drug from United Therapeutics, Liquidia's product is better able to deliver higher doses in a safer way leading to better patient outcomes.

In the past, Liquidia CEO Roger Jeffs said that he thought they could take 80 to 90 percent of the market from United Therapeutics. Obviously that was an aggressive statement, but shows both the company's ambitions and Jeffs' confidence in their product. Yutrepia will undoubtedly take a significant amount of market share in a growing market. We should know later this year whether that number is 20% or 80%.

Because the range of potential outcomes is so wide, valuation right now is difficult. However, we did recently receive a clue. Mannkind owns a 10% royalty of the United Therapeutics PAH drug, Tyvaso DPI. In early January, Mannkind sold 1% of that royalty to a third party for a base price of \$150 million. Using that valuation as a baseline, if Liquidia takes 50% of the market share, shares should trade more than seven times higher than they do now.

### **Vistry**

There are periods of planting and harvesting for positions in a portfolio. For Vistry, the planting phase took longer than expected. We have finally entered the harvesting period.

Last quarter I discussed our history with Vistry and Countryside, the company we originally owned until it was bought out by Vistry. When that acquisition was announced in November 2022, Vistry said that if the combined company did not get a proper valuation, they would focus entirely on their partnerships model and transition out of the traditional homebuilding model. They announced that they would begin doing this last September.

This transition opened the door to significant buybacks due to the asset light nature of the partnerships model. Vistry committed to £1 billion in share buybacks over the next three years. They began buying in December and have been in the market nearly every day. Even with that, they will need to pick up the pace to hit their buyback goal. This is a good problem for us, as shareholders, to have.

We have full alignment from the board, management, and all major investors on the strategy shift. The CEO is best in class and owns more than £10 million of shares, including a £5 million purchase after the Vistry/Countryside combination.

The bottom line is that shares are extremely cheap now. This is a good thing as they buy back shares. If they can come anywhere close to their medium-term goals, which includes an operating profit of £800 million, shares will be dramatically higher than today. Even at today's operating profit, shares trade at 7x EBIT, which is way too low given the business model shift. Comps are nearly double that and do not take into account Vistry's size, scale, and operational excellence. It seems absurd, but I reiterate that if the company hits their medium-term goals, shares can trade up to £50 per share from £9.38 today.

Vistry (and Liquidia) are two of the best risk/reward stocks in the market. We are in the harvesting phase for both.

Vistry shares gained 47% in 2023 and have continued to climb so far in 2024.

### **Lifecore**

Lifecore is currently going through a process to sell itself. The question is whether they will be able to do it at an attractive price. The complicating factors are Lifecore's history and their ability to get current on their financials and past year's audit.

Today, Lifecore is a pure-play Contract Development and Manufacturing Organization (CDMO). They are the leading manufacturer of hyaluronic acid and pre-fill injectables. There is not enough fill capacity in the overall markets relative to demand, and it takes several years to get regulatory approval to increase supply. Lifecore is in a unique position in that they have dramatically increased their manufacturing capabilities.

The demand is there. They have significantly expanded their relationship with an existing long-term customer. This customer also provided financing to Lifecore earlier last year, saving them from a potential bankruptcy situation.

Since then, Lifecore has put itself up for sale. That process has been difficult so far for several reasons. First, until about a year ago, the company also had an unrelated subsidiary in the food business. They sold that subsidiary but have had difficulties to this day completing the audit and previous years financial reports. These restatements do not involve the CDMO business, but this messiness is certainly impacting the overall sales process of the company.

About a month ago, the company announced that they expected to be able to file their delinquent financial reports soon. While I would have expected this to be complete by now, to date these filings have not been made. Clearly there are issues with management, which I believe is why the company is so cheap. The CDMO business itself, though, is a jewel.

I hesitate to publicly share a projected buyout price because this process has taken a few twists and turns over the past year. However, with shares under \$7, I believe we could see substantial gains in a buyout with the potential for a lottery ticket-type offer.

A potential near term catalyst is the ownership by an activist hedge fund. The activist joined Lifecore's board in January 2023 and has been the driver in the company's restructuring. The fund will be allowed to increase their ownership stake beyond 9.9% of the company beginning on February 22, 2024. It remains to be seen what this means, but it may be a clue regarding Lifecore's eventual sale.

#### **ENDI**

I have written about ENDI ad nauseum through the years. To save you from additional boredom on the subject, I will simply reiterate that I believe shares are exceptionally undervalued at this price. It is a small and underfollowed company, but I continue to be impressed with their operational performance. The stock price will follow at some point.

#### **Nam Tai Property**

Nam Tai had an eventful year. One year ago, I thought our investment was at risk of a total loss. Since then, the board of directors has been able to get control of the company and its "chops" from the previous management. Shares have risen 257%, and I have renewed optimism that the company will ultimately sell itself at a price measurably higher than today's stock price.

Nam Tai has won several court and arbitration cases in the past year against its former management. This includes an arbitration case that is worth \$2 to \$3 per share with a significant amount of that award in an escrow account, making collectability a non-issue. Shares ended the year at \$4.75.

Skin in the game for Nam Tai comes from its controlling shareholder, activist fund Oasis Capital. Oasis recently made additional open market purchases near today's share price and owns approximately 20% of the company.

I continue to believe that the end game for Nam Tai is a sale of the company at a share price above \$10.

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A few administrative details. We have switched to a new tax provider and a new third-party administrator, Formidium. Formidium offers lower fees and, so far, has provided superior service compared to our previous provider. We expect Formidium to deliver the K-1s in late March. Going forward, investor statements will also be sent to you by Formidium.

We continue to use Wipfli as our auditor. You may receive communications and verification requests from Wipfli as they perform their work. The sooner you complete and return these items, the sooner we

can receive the fund's final audit. I appreciate your cooperation. If you have any questions about our service providers or their processes, please let me know.

Thank you again your commitment to Arquitos, and best wishes for 2024.

Best regards,

Steven L. Kiel

**Arquitos Performance Compared to the S&P 500**

	<b>Arquitos (Gross)</b>	<b>Arquitos (Net)</b>
<b>2023</b>	23.3%	22.1%
<b>2022</b>	-52.5%	-52.9%
<b>2021</b>	56.5%	54.9%
<b>2020</b>	-1.3%	-2.3%
<b>2019</b>	-13.8%	-14.7%
<b>2018</b>	-30.6%	-31.3%
<b>2017</b>	80.8%	64.0%
<b>2016</b>	65.4%	54.9%
<b>2015</b>	-14.0%	-14.8%
<b>2014</b>	72.8%	57.8%
<b>2013</b>	58.7%	46.6%
<b>2012*</b>	9.0%	7.2%
<b>Annualized</b>	<b>12.9%</b>	<b>8.9%</b>

\*Founded April 10, 2012

**Disclaimer**

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*Performance returns presented above are for Arquitos Capital Partners, LP and reflect the fund's total return, net of fees and expenses, since its April 10, 2012, inception. They are net of the high water mark and the 20% performance fee, applied after a 4% hurdle, as detailed in the confidential private offering memorandum. Arquitos Capital Offshore, Ltd. was launched on March 1, 2018. Returns from Arquitos Capital Offshore, Ltd. may differ slightly and are not presented here.*

*Performance returns for 2023 are estimated by our third-party administrator, pending the year-end audit. Actual returns may differ from the returns presented. Positions reflected in this letter do not represent all the positions held, purchased, or sold.*

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