

February 2022

Dear Partners,

For the fourth quarter, 1 Main Capital Partners, L.P. (the “Fund”) returned 4.7% net of fees and expenses, bringing the year-to-date return to 61.1%¹. Since its February 2018 inception, the Fund has delivered an annualized net return of 30.3%, compared to 16.4% for the S&P 500 and 10.8% for the Russell 2000.

Reflecting on the now four-year period during which the partnership has been investing, a major observation is that equity markets have compounded at an above-average rate, though have done so with periods of significant volatility along the way.

Volatility is a double-edged sword that can harm performance or augment it depending how one reacts to it. Thus far, it has largely been our friend. The conscious decision to avoid portfolio leverage and high-flyers has enabled me to keep a cool head when volatility has increased and make what I believe to be sensible investment decisions along the way.

Importantly, I remain confident that our recipe for success is not only scalable and repeatable, but also continues to improve. The length and quality of the Fund’s watch list has expanded meaningfully compared to its size at inception. Position sizing has migrated from a gut feel to a blend of quantitative and qualitative items. Lastly, I have a much better understanding today for how various factors impact our existing and prospective holdings and am confident our portfolio can perform well in a variety of economic scenarios.

It is way too early to know all the surprises 2022 has in store for us, but I am eager to capitalize on whatever opportunities that the market presents as they arise. Lastly, I remain very excited about the prospects for the Fund based on the combination of significant growth *and* valuation support that our existing holdings offer.

Top 5 Positions

As of December 31st, the Fund’s top 5 positions were Alphabet Inc (GOOG), Basic-Fit NV (BFIT), KKR & Co (KKR), Mastech Digital (MHH) and RCI Hospitality (RICK). Together, these holdings accounted for nearly 60% of assets. I have written about 4 of these holdings in prior letters and not much has changed in our thinking. I discuss BFIT, which is a new position for the Fund, below.

As you will see in the Outlook section below, I am very focused on the economic challenges associated with supply chain disruptions and labor shortages. For this reason, it is worth noting that our top 5 positions are concentrated in service businesses that have minimal inventory requirements and limited exposure to low wage labor.

¹ Performance data is presented for the Fund’s Class A Interests, and is net of any accrued incentive allocation, management fees and other applicable expenses (as disclosed in the Fund’s Confidential Private Offering Memorandum), include the reinvestment of dividends, interest and capital gains, and assume an investment from inception. Returns for month-end and year to date 2021 are estimated, and un-audited. For investor specific returns, please refer to your capital statements. Due to the format of data available for the time periods indicated, net returns are difficult to calculate precisely. Please see the last page for important disclosure information.

Basic-Fit NV (BFIT)

Basic-Fit is the largest low-cost gym operator in Europe, with >1,000 locations supporting >2 million members who pay the company €20 per month, on average. The company operates primarily in France (500+ clubs) and Benelux (400+ locations), with an emerging presence in Spain and probably at least one additional market that has likely already been chosen but is yet to be announced.

At €40 per share, the stock currently sells for 11x my estimated maintenance FCF per share, assuming the existing store base gets back to pre-COVID levels of membership in the coming years. Importantly, the European gym market is still extremely under-penetrated, meaning that BFIT has an opportunity to reinvest its maintenance FCF back into building new locations at predictable and attractive returns.

Specifically, only 1 in 10 European adults is a member of a fitness club today, less than half the level in the US. Additionally, while low-cost gyms account for nearly 1/3 of US membership, European gyms are still by and large independently owned and operated. Generally, independent gyms provide inferior experiences while also operating with higher cost structures than BFIT's.

When it comes to the member experience, BFIT offers two clear benefits compared to independent operators: i) newer and cleaner facilities with shorter equipment refresh cycles when compared to independents, and ii) the ability to exercise at multiple locations near work, home, or when traveling through Europe. It also has a mobile fitness app that is available to members at no additional cost.

As for its cost structure, BFIT benefits from lower buildout costs and lower ongoing operating expenses. For example, since the company is considered a high-quality tenant whose presence increases real estate values, it is given preferential leases at the best locations with favorable landlord-funded improvement allowances. It also gets significant discounts on equipment purchases given its scale. According to management, BFIT build-out costs for independent operators are estimated to be 30-40% higher than their own.

Lastly, BFIT gyms require significantly lower levels of staffing per location than independent operators. They benefit from digitized signups, automated access controls and centralized billing, marketing, and other G&A. They also spend less than peers on keeping locations clean, as the independent on-site personal trainers not only make sure the locations remain clean and orderly, but actually pay the company rent for the exclusive right to train at those locations.

Nick Sleep articulated the concept of "scale economies shared" where, as a firm benefits from scale, savings are given back to customers in the form of lower prices, allowing the firm to gain market share, which in turn provides even greater scale for the firm to pass on. BFIT encapsulates the concept well. It sells a newer and better offering for a lower cost than competition, leading to more efficient customer acquisition, which drives per-member costs down even further.

In terms of unit economics, a new location typically costs approximately €1.2 million to build, supports 3k+ members, and generates around €375k in annual EBITDA less maintenance capex at maturity, generating greater than 30% pre-tax returns on capital.

Achieving such a rapid payback on new units should allow the company internally fund rapid expansion via unit growth, and at some point pursue aggressive share repurchases as well. Specifically, I think the company can more than triple its unit count by 2030 while also significantly reducing its share count.

The combination of i) high and defensible ROICs, ii) a large and underpenetrated market, and iii) an attractive entry valuation can lead to powerful equity returns. From current levels, I think BFIT has a good chance to deliver the goods.

Outlook

As I sit here thinking about the coming year, topics du jour I hear from pundits include runaway inflation, supply chain disruptions, labor shortages, Fed tightening, and escalating tensions in Ukraine.

Against this backdrop of things to worry about, broad index valuations are within historical ranges and continue to look reasonable, especially relative to interest rates which are still well below historical levels.

Despite reasonable index valuations, however, there is an incredible amount of dispersion when one looks under the hood at single companies. On one hand, there are areas of the market that are pricing in highly optimistic outcomes, ascribing extremely favorable valuations to businesses with little or no earnings power. On the other, there are a significant number of names that appear to be pricing in a material contraction of earnings in the coming years.

However, I see the potential for strong demand and healthy economic expansion. US consumers account for approximately 70% of GDP and are the key driver of our economy. We can usually count on them to consume. On top of that, household balance sheets and earnings trajectory remain in great shape.

Even with strong consumer demand, it is possible for corporate profits to suffer from lost revenue and margin contraction. This is especially the case if supply remains constrained (labor shortages and supply chain disruptions) or should the Fed enact monetary policy that causes a rapid increase in interest rates to address inflation.

However, in my view, capitalism is well equipped to address these challenges. Every commodity investor knows the saying that “the best cure for high prices, is high prices.” I think this is the case with many of the inflationary pressures we see across the world right now.

Regardless, I continue to believe that the best way to ensure that the purchasing power of our hard-earned savings expands over time rather than be inflated away is to own high-quality, well-capitalized, well-run businesses that are poised to grow long-term earnings per share. As such, these are the types of investments we continue to hold in the Fund.

Importantly, our holdings are cash generative and sell for reasonable multiples of earnings. The strong earnings power and earnings growth of our portfolio should help insulate it from the broader de-rating we are seeing in speculative growth stocks. Many of our portfolio companies also have the financial wherewithal to capitalize on an economic slowdown and play offense if the economy does in fact slow.

So, despite the recent market turbulence, the Fund is sticking to its knitting. Owning beta into a wall of worry has historically paid handsomely as the market climbs over the wall. I believe this time will be no different. As such, I do not aim to minimize drawdowns during market corrections. Instead, I will use careful stock selection which should hopefully allow alpha and beta to compound together over time to deliver us results that are at a minimum satisfactory and hopefully wonderful.

Other Updates

As the Fund continues to scale, I am looking to add an analyst to the research team to help me more quickly evaluate potential investments and increase the velocity of ideas we look at so that I can continue

to high-grade our portfolio over time. If you know of any qualified candidates, please have them send their resume and cover letter to careers@1maincapital.com.

As always, thank you for your continued support and confidence. Please reach out with any questions at yaron@1maincapital.com or 305-710-8509.

Sincerely,
Yaron Naymark

Monthly Performance Summary²

2021	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
1 Main Capital Partners - Gross	10.5%	10.0%	1.1%	19.0%	-2.3%	5.3%	5.8%	3.1%	2.3%	10.4%	-6.9%	2.8%	77.4%
1 Main Capital Partners - Net	8.4%	8.1%	0.9%	15.7%	-2.0%	4.5%	4.9%	2.6%	1.9%	8.9%	-6.1%	2.4%	61.1%
S&P 500 index - incl dividends	-1.0%	2.8%	4.4%	5.3%	0.7%	2.3%	2.4%	3.0%	-4.7%	7.0%	-0.7%	4.5%	28.7%
Russell 2000 - incl dividends	5.0%	6.2%	1.0%	2.1%	0.2%	1.9%	-3.6%	2.2%	-2.9%	4.3%	-4.2%	2.2%	14.8%

	One Year	Three Year	Since Inception	Inception Annualized
1 Main Capital Partners - Gross	77.4%	58.5%	256.9%	38.4%
1 Main Capital Partners - Net	61.1%	47.2%	181.9%	30.3%
S&P 500 index - incl dividends	28.7%	26.1%	81.2%	16.4%
Russell 2000 - incl dividends	14.8%	20.0%	49.3%	10.8%

² Performance Data is presented for the Fund's Class A Interests, and are net of any accrued incentive allocation, management fees and other applicable expenses (as disclosed in the Fund's Confidential Private Offering Memorandum), include the reinvestment of dividends, interest and capital gains, and assume an investment from inception. Returns for month-end and year to date 2021 are estimated, and un-audited. For investor specific returns, please refer to your capital statements. Due to the format of data available for the time periods indicated, net returns are difficult to calculate precisely. Please see the last page for important disclosure information.

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Past performance. In all cases where historical performance is presented, please note that past performance is not a reliable indicator of future results and should not be relied upon as the basis for making an investment decision.

Risk of loss. An investment in the Fund will be highly speculative, and there can be no assurance that the Fund’s investment objective will be achieved. Investors must be prepared to bear the risk of a total loss of their invested capital.

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