CAPITAL MANAGEMENT

June 2021

LRT Capital Management

"The Vision to See Economic Moats"

Executive Summary

- LRT Capital Management, LLC ("LRT") is an independent investment manager based in Austin, TX with current AUM of ~$85 million.[1]

  - LRT invests in a concentrated portfolio of companies with competitive advantages, purchased at attractive valuations, and held long term.

  - LRT seeks to identify companies with sustainable, durable competitive advantages ("moats") when their share prices trade at low valuations due to market inefficiencies.

  - Lukasz Tomicki founded LRT in 2012 which initially operated as private investment vehicle for Mr. Tomicki and his family. The Economic Moat Strategy opened its doors to outside investors in 2017.

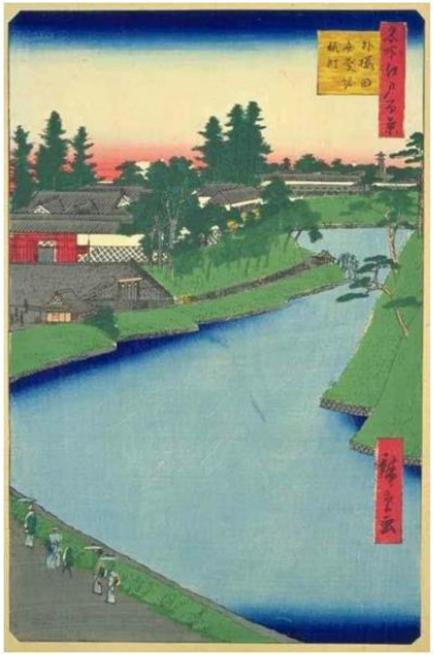
Investor Type Breakdown	HNWI	Internal	Fund of Funds	Family Office	Foundation
	27%	23%	19%	28%	3%

(1) As of June 2020

Investment Philosophy

Why We Invest – Investment Philosophy

- LRT aims to beat the S&P 500 by a substantial margin over a full market cycle.
  - We do not time the market or make investment decisions based on macro events.
  - Frenzied markets dominated by short-term traders and index investors have created an opportunity for our style of qualitative fundamentally-driven analysis.
- Business values can often diverge from market prices due to market inefficiencies.
  - The intrinsic value of a company is driven by:
    - The return on invested capital (“ROIC”) of the business
    - The ability to re-invest capital at a high incremental ROIC.
- We conduct primary source research to find undervalued businesses.
- We focus on three sources of perpetual inefficiency and mispricing:
  1. Moats
  2. Growth
  3. Management’s Capital Allocation Skills



What We Look For

We Focus on moats, management, and long growth runways – all three are sources of perpetual inefficiency and mispricing

Competitive Advantage (Moat)	❑ Moats are structural competitive advantages that protect the business: – *Intangible assets, network effects, high switching costs, process or scale-based cost advantages.* ❑ High returns attract competition…absent a moat, high profits will be competed away. ❑ Moats insulate businesses from competition and allow capital to be compounded at a high incremental rate of return.
Growth	❑ Companies with moats and re-investment opportunities deserve a premium valuation. They almost never appear 'cheap' to traditional value investors. ❑ For companies without growth opportunities, having a moat reduces uncertainty…but does not add much value to the business.
Capital Allocation	❑ Good management allocates capital to deepen and broaden the economic moat. Bad management invests outside their competitive advantage, diluting overall returns. ❑ Management is the link between business value and shareholder value.

Why We Focus on Moats – Quantitative vs Qualitative

Quantitatively focused investment strategies are being arbitraged away very quickly due to advances in computing power, machine learning techniques and new data sources.

Quantitative information is priced very efficiently by the markets…

$$
\begin{aligned}
&\sum \bar{M}_{G1} + \sum \bar{M}_{G2} + \ldots + \sum \bar{M}_{GN} \\
&= m_1 \begin{pmatrix} \bar{r}_1 \times \bar{a}_G + \bar{r}_1 \times (\bar{\alpha} \times \bar{r}_1) \\ + \bar{r}_1 \times (\bar{w} \times (\bar{w} \times \bar{r}_1)) \end{pmatrix} \\
&\quad + m_2 \begin{pmatrix} \bar{r}_2 \times \bar{a}_G + \bar{r}_2 \times (\bar{\alpha} \times \bar{r}_2) \\ + \bar{r}_2 \times (\bar{w} \times (\bar{w} \times \bar{r}_2)) \end{pmatrix} \qquad (5) \\
&\quad + \ldots + m_N \begin{pmatrix} \bar{r}_N \times \bar{a}_G + \bar{r}_N \times (\bar{\alpha} \times \bar{r}_N) \\ + \bar{r}_N \times (\bar{w} \times (\bar{w} \times \bar{r}_N)) \end{pmatrix}
\end{aligned}
$$

$$
\begin{aligned}
\partial_t E_\pm &= i\tfrac{c^2}{2\nu}\partial_x^2 E_\pm - (\kappa + i\nu)E_\pm - ig^* P_\pm \\
\partial_t P_\pm &= -(\gamma_\perp + i\omega_0)P_\pm + i\tfrac{g}{2}(D_1 \pm D_2)E_\pm + igC_\pm E_\mp \\
\partial_t D_1 &= -\gamma_\parallel(D_1 - 2\sigma) + 3i(g^* E_+^* P_+ - gE_- P_-^* - c.c.) \\
\partial_t D_2 &= -\gamma_J D_2 + i(g^* E_+^* P_+ + gE_- P_-^* - c.c.) \\
\partial_t C_+ &= -\gamma_c C_+ + i(g^* E_-^* P_+ - c.c.)
\end{aligned}
$$

…but qualitative insights are not!

- Qualitative processes are hard to replicate and arbitrage. There is no Bloomberg screening tool for switching costs or network effects.
- Understanding a moat requires “deep knowledge” of a business – hard to achieve in a portfolio of 50+ stocks.
- The presence of a moat makes valuation of a business more certain and improves risk management.
- Moats force you to take a long-term view – an advantage when other market participants are obsessed with quarterly results.

Investment Process & Portfolio Construction

How We Invest – The Process

Idea Generation	- Look for companies with: economic moats, management with good capital allocation skills, and long runway for growth - It pays to 'search in the right neighborhood' – Moats are more common in: media, technology, distribution, specialty retailers, and industrial sectors	- Value chain analysis - Idea database - Trade flow - Industry contacts
Deep Research	- Financial reports, background information, industry trade shows - Analysis of competition and durability of the economic moat and the size of the growth opportunity - Review proxy statements, board composition, and compensation - Contact suppliers and customers if appropriate	**Elimination** - Industries with structurally poor economics – Raw materials, commodity chemicals, agriculture, shipping, and airlines - Countries with poor shareholders & legal systems - Management teams with a track record of bad capital allocation or lack of respect for minority shareholders - Bad incentives, self-dealing, lack of disclosures
Valuation	- Estimate intrinsic value using discounted cash flow - Use other valuation tools to triangulate results	- Maximize safety, minimize opportunity costs - Look to pay a 'reasonable' price for an extraordinary business
Trade Execution	- Purposefully limit the trading activities of the Fund to the first business day of each month - The first business day of the month is usually the liquidity date for the Fund, and the portfolio is rebalanced on this day	- The first trading day of each month is also when positions are removed from the portfolio and new ones added - The LRT trading policy is simple and rule-based. It is designed to be robust and to limit human bias in the implementation of the portfolio

How We Invest - Portfolio Maintenance & Exit

- **LRT separates the discretionary and qualitative process of selecting the equity holdings from the portfolio construction process.**

- This allows us to eliminate human biases such as
  - Overconfidence – seeking to buy more of securities that have fallen in price,
  - Framing – buying or selling securities based on their price relative to the recent history, and
  - Anchoring – refusing to buy securities at all-time highs.

- We believe that the separation of our investment process into discretionary security selection and systematic risk management is unique amongst our peers in the hedge fund industry.

- The position sizing and rebalancing process strives to achieve three important goals:
  1. Volatility minimization in the context of maximizing returns.
  2. Elimination of emotion and bias from portfolio construction.
  3. Prudent risk control, as no single position contributes a large percentage of total portfolio volatility.

- Ongoing position monitoring.

- Disciplined selling: materially weakening moat; substantially better ideas; loss of confidence in the management team; excessive valuations.

How We Manage Risk

The foundation of a professional investment process is risk management

Risk Management

Risk of Capital Loss

- Buy Discipline: Strong competitive advantages; Management with demonstrated history of good capital allocation; long growth runway
- Portfolio & Position Sizing: Typically, we hold a portfolio of 30-40 long equity positions and 4-6 short market index hedges
- Continuous portfolio rebalancing and sell discipline

Inflation Risk

- Always be fully invested
- Invest only in productive assets – equities
- Only invest in companies with substantial pricing power and competitive advantages in best positions to pass on any inflationary price increases to their customers
- Prefer investments in companies with low capital intensity and high free cash flow

Volatility Risk

- Minimizing short term volatility whenever possible without sacrificing long term returns is a key part of process.
- Through our portfolio construction process, we hold a portfolio of equity securities with high expected returns, low internal correlation and volatility below that of the overall market.

Operational Risk

- Limited trading and the trading approaches employed results in lower operational risk. Operational risk is further mitigated in several ways:
- The Fund only holds highly-liquid securities traded on major global exchanges.
- Trade reconciliation is performed immediately following the transactions.
- Backup computer systems and data systems are maintained as preventive cyber risk measures.

Portfolio Construction & Service Providers

	Economic Moat Fund	First Loss
Exposure	▪ 300-340% Gross ▪ 60-100% Net ▪ 0.4–0.6 Beta to the S&P 500	▪ 170-190% Gross ▪ 10-30% Net ▪ 0–0.1 Beta to the S&P 500
Total Number of Positions	▪ 30-40 Long Equity Positions ▪ 4-6 Market Index Hedges	▪ 30-40 Long Equity Positions ▪ 4-6 Market Index Hedges
Position Size Limits	▪ Maximum: 10%, excluding hedges	▪ Maximum: 10%, excluding hedges
Market Cap Exposure	▪ Market cap and geographically agnostic	▪ Market cap and geographically agnostic
Portfolio Liquidity	▪ Typically Investing in securities with at least $10 million of daily liquidity	▪ Typically Investing in securities with at least $10 million of daily liquidity

Auditor	Prime Brokers	Administrator	Legal Counsel	Compliance
EisnerAmper LLP	Interactive Brokers Wells Fargo Prime	Fleming Fund Services	Winston & Strawn LLP	Blue River Partners

Fund Terms

Fees	Management	▪ 1%
	Performance	▪ 20%
Lockup		▪ None
Side Pockets		▪ None
Soft Dollar Arrangements		▪ None
High Water Mark		▪ Yes
Minimum Investment		▪ $1,000,000
Redemption		▪ Monthly, with a 30-day notice
Reporting		▪ Monthly performance and quarterly letters

LRT Capital Management, LLC

108 Wild Basin Road. Suite 250 | Austin, TX 78746

Lukasz Tomicki

Founder & Portfolio Manager

ltomicki@lrtcapital.com

O: +1 (512) 852 4320

C: +1 (314) 762 7909

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LRT Capital Management, LLC uses the S&P 500 for comparison purposes only. The S&P 500 measures the stock performance of 500 large companies listed on stock exchanges in the United States. The Fund does not attempt to replicate the performance of any index. In addition, the Fund may have strategies, including the use of leverage, which may result in material difference between the returns of the Fund and any index. The comparisons should not be understood to mean there will necessarily be a correlation between the Fund's returns and any index. The performance of indices shown may not fully reflect management, performance or other fees and expenses that may be incurred to invest in an indices' underlying securities. References to indices herein are for informational and general comparative purposes only. There are significant differences between such indices and the investment program of the Fund. The Fund does not invest in all or necessarily any significant portion of the securities, industries or strategies represented by such indices. References to indices do not suggest that the Fund will, or is likely to achieve returns, volatility or other results similar to such indices. Indices are not managed and have no fees and expenses.