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Legacy Ridge Capital Partners Equity Fund I, LP

2021 Annual Letter

To December 31st 2021:	LRCP Equity Fund I Gross	LRCP Equity Fund I Net	S&P 500	Russell 2000	MSCI World Index
Trailing 1-yr Total Return:	41.8%	32.4%	28.7%	14.8%	22.4%
Trailing 2-yr Total Return:	56.8%	44.3%	52.3%	37.8%	42.5%
Trailing 3-yr Total Return:	60.8%	47.9%	100.4%	72.8%	82.5%
Trailing 4-yr Total Return:	54.6%	42.3%	91.6%	51.8%	69.9%

The figures above are on a cumulative basis and are unaudited. Future results will also be presented on a cumulative basis in this section. Annual results will be illustrated below for those who wish to measure us based on 12-month cycles. However, we view the cumulative results as most meaningful since we are trying to build wealth far into the future and the annual results are only important in as much as they contribute to a 3, 5, 10, and 20-year track record.

Annual Results:	LRCP Equity Fund I Gross	LRCP Equity Fund I Net	S&P 500 Energy	AMZ	XAL
2021:	41.8%	32.4%	53.3%	39.9%	-1.7%
2020:	10.6%	9.0%	-33.7%	-28.8%	-24.2%
2019:	2.5%	2.5%	11.8%	6.5%	21.3%
2018:	-3.8%	-3.8%	-18.1%	-12.4%	-22.4%

To reiterate, our goal is to have good absolute returns first and foremost, which should lead to good relative returns versus the broader markets. However, I also think it's important to highlight the performance of the primary sectors in which we feel we have an advantage and in which we invest. There is no reason to present this other than for transparency reasons. Owning a highly concentrated portfolio will prevent our results from looking like anything we compare them to in most years, but knowing the performance of energy broadly, midstream energy specifically, and North American airlines will add some context for those partners who wish to do some higher-level analysis. Please see the accompanying disclaimer & footnotes at the end of the letter for a broader description of each of these indices.

"a business earning 20% on capital can produce a negative real return for its owners under inflationary conditions not much more severe than presently prevail. If we should continue to achieve a 20% compounded gain—not an easy or certain result by any means—and this gain is translated into a corresponding increase in the market value of Berkshire Hathaway stock as it has been over the last fifteen years, your after-tax purchasing power gain is likely to be very close to zero at a 14% inflation rate…

…the inflation rate plus the percentage of capital that must be paid by the owner to transfer into his own pocket the annual earnings achieved by the business (i.e., ordinary income tax on dividends and capital gains tax on retained earnings)—can be thought of as an "investor's misery index"…We have no corporate solution to this problem; high inflation rates will not help us earn higher rates of return on equity.

One friendly but sharp-eyed commentator on Berkshire has pointed out that our book value at the end of 1964 would have bought about one-half ounce of gold, and fifteen years later, after we have plowed back all earnings along with much blood, sweat and tears, the book value produced will buy about the same half ounce. ***A similar comparison could be drawn with Middle Eastern oil. The rub has been that government has been exceptionally able in printing money and creating promises, but is unable to print gold or create oil.****"*

Warren E. Buffett—from the 1979 Berkshire Hathaway shareholder letter.

Buffett's assessment of the deleterious impact high rates of inflation have on wealth creation is relevant to all investors today. He wrote this forty-two years ago, a time that most closely resembles the current macro environment than any period since. And while Nate and I won't pontificate on future rates of inflation, we do know December's Consumer Price Index (CPI) advanced 7%, the highest rate in forty years, and the Producer Price Index (PPI) rose 9.6%, the highest rate since the data was first tracked in 2010. Buffett's "investor's misery index" is pointing up.

Our portfolio is very well positioned to excel in such environments.

RESULTS FOR 2021

The partnership gained 42% gross of performance fees last year. I would characterize the results as acceptable. While four-times the prior year's return, Nate and I think we did a much better job in 2020. Putting up decent results when everything you own was down in the year is much harder than putting up decent results when everything was up. And while investing is never easy, last year felt a bit easier. The absolute return of the portfolio was great, and relative to broader indices it was good, but compared to energy indices we could have done a bit better. Midstream energy stocks underperformed upstream stocks by a decent amount, and we have a general aversion to most upstream investments. Returns on and of capital tend to be quite poor for those businesses, and while that's changing for some, we know that what's good for upstream will ultimately be good for midstream, so we're currently focused there.

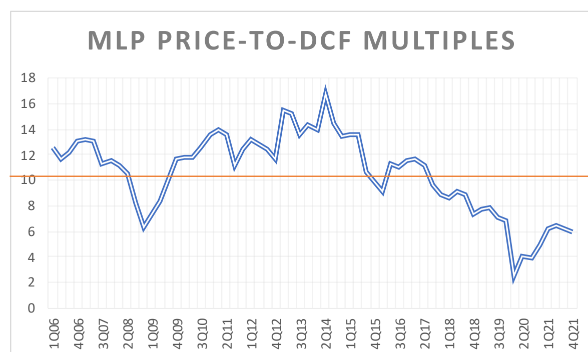
The cumulative gross return of the partnership since it was started four years ago is +55%. That's underwhelming when compared to the broader indices referenced above. Our specialties are capital intensive, un-ESG(ish), cyclical, and "value", which have been investing gale force headwinds the past several years. No excuse, just an observation. Regardless, it's imperative we beat the broader indices over the long-haul if we're to have done our job properly.

The great news is that we feel like these headwinds are finally shifting to tailwinds for a strategy like ours—a strategy that focuses on free cash flow and returns of capital, while insisting on reasonable returns on our capital. The passive investing community has forfeited their opportunity for reasonable returns in our opinion. With the S&P 500 doubling the last 3-years, expected future returns have definitively come down. It's the only way to justify buying "the market" at current prices. If you expect low-single-digit returns you can pay over 20x for an asset. We continue to expect more from our investments.

We remain optimistic about our portfolio

There are several reasons we think our portfolio still has meaningful upside, even after a good year.

1) Midstream energy remains cheap. Updating the Distributable Cash Flow chart for 2021 results shows that valuations are still a long way off from historical averages. And while the average can move down if there's a structural shift in multiples, we're fine betting there's still a strong bias against energy that at least partially reverts in time. Over the past 15-years the average DCF multiple is 10.5x and we ended 2021 at 5.9x, suggesting 78% upside to get back to the average. And that math assumes no fundamental improvement in the denominator (cash flows), which is not at all consistent with commodity prices, current E&P activity levels and implied future energy production.



Additionally, although the cumulative return of our portfolio over the past 4-years is positive, the returns in the sectors we've been focusing on are not. The Alerian Midstream Index (AMZ) and S&P 500 Energy sub-sector are each down 7% cumulatively, while the NYSE Arca Airline Index (XAL) is down close to 30%. These

sectors remain massive underperformers over a multi-year period, so we are still fishing in fertile waters.

2) If valuations don't revert closer to the mean, we'll still get acceptable returns. Remember that DCF is essentially a FCF metric for midstream, but it uses maintenance capex as opposed to total capex. Most of midstream is in maintenance mode and will be for several years as asset utilization increases on existing infrastructure. The cash flow yield on these companies is close to 17% and we own a few with yields over 20%. Whether the cash gets returned through distributions, stock repurchases, or even debt reduction, we don't particularly care.

   And while Vistra (VST) isn't a midstream company it does offer the same value proposition. Shares trade at a 20%+ FCF yield, management pays a modest dividend, gradually reduces debt, and most importantly, is repurchasing over 20% of the outstanding shares over the next year.

3) We receive a decent amount of cash every quarter from dividends, which allows us to find new opportunities or add to existing positions without having to sell anything. Owning a handful of volatile stocks makes this compelling since several of our positions had a 60%+ dispersion between the 52-week high and 52-week low in calendar year 2021. We think of ourselves as long-term investors, but we have no problem taking advantage of volatility on either side.

4) The portfolio we own today is hardly the portfolio that got us here. Not one of today's top 3 positions gained as much as the overall portfolio in 2021. We aren't counting on outperformers continuing to outperform.

5) Our portfolio should fare well during periods of high inflation.

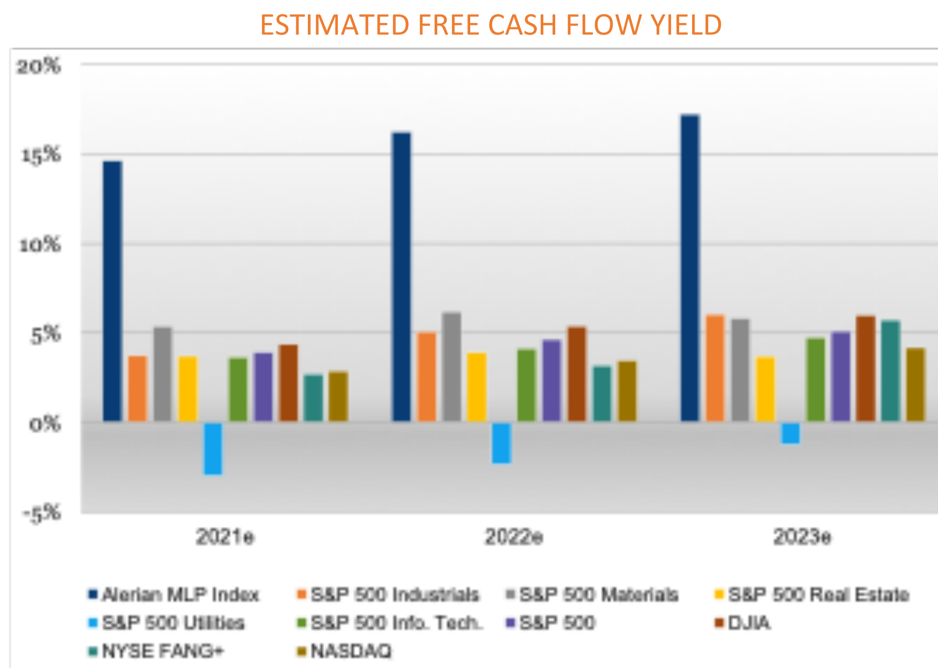
Inflation vs. LRCP

If a period of sustained high inflation is ahead of us, our portfolio should perform well on an absolute and relative basis because we own short duration investments, high inflation is synonymous with high energy prices, our companies predominantly own assets with contract structures that adjust for inflation, and we own real assets.

Higher inflation leads to higher interest rates, and higher interest rates lead to higher discount rates. Future cash flows are simply worth less today as discount rates go up and the further out in the future that cash is received, the more negatively its present value is impacted. Bond investors simplified the idea and call it duration. High duration cash flow streams are the most impacted by changing interest rates, e.g., zero coupon bonds or low-to-no cash flow equities. Rates go down, price goes up; rates go up, price goes down. We own low duration assets. The present value of our holdings is captured in the very near future. Whether transmitted through meaningful cash dividends, massive share repurchases, or significant deleveraging, we own high free cash flow stocks that return capital to us in one form or another.

In fact, every stock in the portfolio has at least a mid-teens FCF yield and single-digit EBITDA multiple, versus the S&P 500 at a double-digit EBITDA multiple and low-single-digit FCF yield. Mathematically our investments should be more resilient.

Below is a chart produced by Chickasaw Capital Management comparing the FCF yield of the Alerian MLP Index to other sectors and indices. The dislocation in relative values couldn't be more apparent.



Source: Bloomberg, LP. at 9/30/2021. Using Bloomberg definition of Free Cash Flow to Equity of cash flow from operations (CFFO) less capex. BPMP has no consensus estimate; therefore we use CCM's estimate.

Next, a major component of CPI and PPI baskets is energy, and although it's stripped out of "core" inflation, energy impacts most other components directly through input costs. When inflation is high, energy prices are high, and high energy prices are good for the fundamentals of the businesses we own, even though the direct correlation is relatively modest. Our companies primarily benefit from the signal higher oil and gas prices give producers, which ultimately leads to increased production. The volume impact on our companies is meaningful since asset utilization increases and incremental returns on capital improve. With the US land rig count still 27% below pre-pandemic levels, and hydrocarbon production over 1 million barrels a day lower, we have room to improve, and all indications are we will. There were 586 rigs drilling on US land as of year-end[1], up from a low of 244 in August 2020, but well below the 2,000 or so we saw in the middle part of the last decade. We doubt we get back to that level of drilling activity, but a doubling of the rig count over the next few years is plausible, and as a result crude oil, natural gas and natural gas liquids volumes could grow mid-to-high-single-digits over that time frame and potentially much longer.

[1] Baker Hughes Rig Count Data as of December 23, 2021.

Additionally, most midstream assets have contracts that adjust according to a price index. For example, interstate liquids pipelines in non-competitive markets have regulated tariffs that reset every July based on the prior 12-month Producer Price Index, plus .78%. With PPI about 6-7% higher lately (ignoring the latest reading of +9.6%), FERC regulated liquids pipelines will be able to adjust their rates by 7%+ in July 2022. Apart from federally regulated pipelines, most other midstream assets have contracts that contain inflation adjusters embedded in them as well. In fact, when Enterprise Products Partners' management was asked on their 3rd quarter call how much of their business had "inflation offsets", they estimated over 90% of the company's revenue had such escalators benchmarked to various indices. And when asked how their capital allocation policy might adjust in a higher inflation environment, they said their goal was to maintain purchase power parity through distribution growth. The business and the capital allocation policy will help offset potentially rampant inflation.

Lastly, the old investing cliché of "own real assets in inflationary periods" is back in vogue. Real asset prices appreciate as replacement cost goes up. And not only are the assets worth more, but the barrier to entry goes up as future returns on capital for aspiring competitors goes down, all else equal. We own land, buildings, pipes and plants. Our assets are as real as it gets.

A Quick Word on Taxes

The other component of Buffett's "investor misery index" is taxes. While political stagnation probably prevents taxes from going up near-term, our portfolio is also built to minimize their burden.

Apart from last year when we exited our preferred securities, our strategy should limit turnover and capital gains just due to the nature of the investments we make and the business-owner mindset we employ. We strive to buy company's we want to own for a long time at valuations that allow us to do so.

Additionally, most of our dividend income is tax deferred because it comes from MLPs. Approximately 80% is treated as return of capital since heavy depreciation drives a significant wedge between the reported GAAP income and actual cash earnings of midstream businesses. As Partnerships, those gains or losses get passed through to us, the Partners. Between 2019 & 2020, I personally showed an Ordinary Business Loss (as reported on my K-1s) of approximately 19% of my average capital balance, despite a portfolio gain of 14%. These losses will be used to offset future Ordinary Business Income that gets passed through in time.

Current Portfolio Characteristics

We have fully exited the preferred securities we purchased in March of 2020. Prices converged back to or above par, and while the yields are still decent the upside is limited. This was a highly opportunistic investment and much shorter than we anticipated. We took advantage of forced selling by over levered closed-end funds, which allowed us to

buy Crestwood preferred securities yielding 40% and DCP preferreds yielding 59%. We hope we get more opportunities like that in the future.

Another noteworthy change in the portfolio was our shift from solely owning Vistra LEAPs (long dated call options), to building a sizable position in the common equity on the back of the Texas deep-freeze last February. As shares fell into the mid-teens we quickly made it a top position believing that events were an anomaly and could in fact make VST a stronger company in the long-term.

As of year-end the portfolio was heavily weighted to 3 stocks, Enterprise Products Partners, MPLX and Vistra. We like the management team and capital allocation strategy of each company and plan on owning them for a long time. These three provide the ballast of the portfolio while a few smaller investments provide the jet fuel. There are 9 positions in the portfolio, but 2 are not meaningful. The dividend yield is ~6%. Cash is near an all-time low at ~4% but it grows 1.5% every quarter!

STOCK REVIEW: Summit Midstream Partners (SMLP)

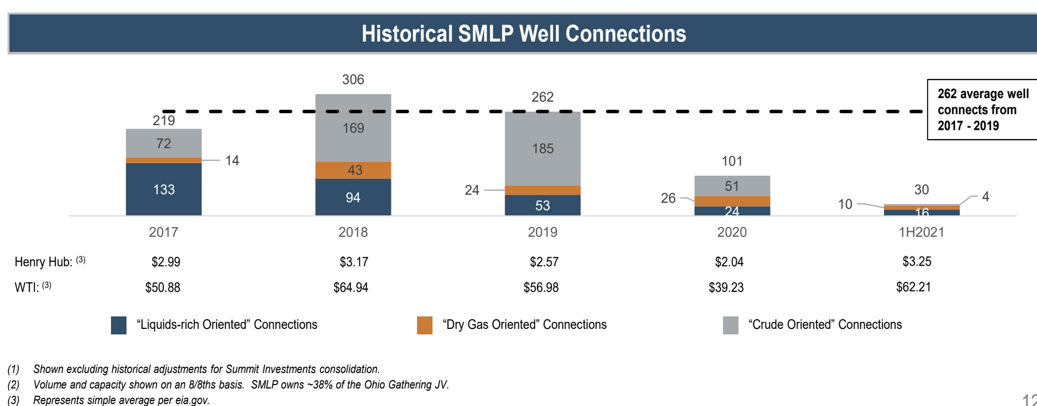
One of my biggest pet-peeves with respect to investment managers is an "error of omission" being a highlighted mistake—missing out on Amazon, Google, etc. In a profession where a 51% success rate can lead to exceptional results, everyone has legitimate mistakes—mistakes where money was lost, not just the lost opportunity cost of money.

SMLP was one of my bigger mistakes (lazy analysis and bad timing perpetuated by inertia) and has been a meaningful detractor to multi-year partnership performance, even despite the stock being up 78% last year. But what's old can be new in investing as facts and prices change, and we think the stock has meaningful upside from here. To start with the conclusion: shares trade for ~$25 and we think fair value is over $75, suggesting 200%+ upside. The market cap is approximately $250 Million and the Enterprise Value about $1.7 Billion. Based on 2021 results SMLP trades at an EV/EBITDA multiple of 7x, a Free Cash Flow to Equity yield of 60%, and has 5x leverage.

As the name suggests, SMLP is a midstream energy company. Specifically, they own and operate Gathering and Processing assets in addition to a new long-haul natural gas pipeline called Double E.

Gathering & Processing:
As discussed in the 2020 write-up on DCP Midstream Partners, gathering and processing is critical to the production of hydrocarbons. Gathering involves collecting hydrocarbons from different well sites and transporting them via pipeline to a central point, usually a processing plant. Once at the processing plant the hydrocarbons get separated into the wet components (oil, naptha, propane, etc.) and the gassier components (primarily methane, but can also be ethane depending on economics). E&P companies usually pay a midstream company to build, own and operate these assets and producers will often dedicate a number of acres and/or a certain amount of volume to a gathering system.

The business is dependent on activity, which is dependent on commodity prices. It's also capital intensive and competitive. For those reasons it's not a great business. However, when production is growing it can be quite lucrative for existing infrastructure with spare capacity, and with their total G&P footprint at a 37% utilization rate, SMLP has plenty of spare capacity. As oil and gas inventories continue to tighten the call on US oil and gas production will resume. The below graph shows well connections to SMLPs systems over the past 5-years. Not surprisingly, EBITDA followed well connections, declining from $288mn in 2017 to $240mn in 2021. While we suspect the correlation will hold as prices and activity move in the other direction, our base case is that EBITDA stays flat around $240mn a year for the G&P segment.



We don't know what the right EBITDA multiple for G&P assets is. It's been as high as 12x and as low as 6x in the past several years. Neither are probably correct. We think of it more on a FCF to equity yield basis, especially when that FCF is paid to equity holders or is used to reduce debt. SMLP's G&P segment generates close to $150mn of FCF. That FCF will go towards the balance sheet for the next several years and if the reduced debt balance gets transferred to equity value (as it should), the equity value will grow to $55 per share over the next two years, just through accretion.

Double E:

Double E is a joint-venture between SMLP (70%) and Exxon (30%) that owns a 135-mile natural gas pipeline put in service at the end of 2021. The pipeline runs through the core of the Delaware Basin and flows from SMLPs Lane processing plant in New Mexico to the Waha Hub in Texas. While the basin isn't known for natural gas exploration and development, drillers inevitably produce associated gas as a byproduct of the crude oil and natural gas liquids they're looking for. Combined with a more economic price for gas, environmental policies that limit gas flaring, and companies' focus on ESG, associated gas must find a commercial market. By partnering with Summit to build and operate Double E, Exxon is finding an outlet for their gas.

Exxon subscribed to 75% of the existing capacity under a 10-year take-or-pay agreement. Securing additional 3rd party agreements will be key to maximizing Double E's value, but with Permian production growing and with 10 Bcfd of gas already processed in the vicinity of Double E, management is optimistic. Total existing capacity on the pipeline is 1.35 Bcfd, but is expandable to 2 Bcfd by adding compression stations. At full capacity Double E will

generate $45mn of incremental EBITDA to SMLP, with upside to $66mn if the pipeline is expanded. Compression would only cost $50mn, taking the cost to build EBITDA multiple from 6.2x to 5x for the project. Generally, a long-haul gas pipeline with long-term commitments from a counterparty like Exxon would sell for 10-12x EBITDA. Therefore, the base case value of Double E 2-3 years from now is $450mn, with an upside case of $790mn. With approximately $200mn of project level financing SMLP's equity stake in Double E is worth $250mn to $600mn, or $25 to $60 a share.

Combining our assessed value for the G&P segment and Double E, we think shares will be worth $80 to $115 within a couple of years, with a present value of approximately $75.

SUMMIT MIDSTREAM

Inertia redux?

The transformation the company has gone through since the fund's initial purchase is stark, so we think the investment proposition is new and my prior mistakes are unlikely to be perpetuated.

Aside from diversifying and improving the asset base with Double E, other key changes include a new CEO, a restructured balance sheet and improved corporate governance. I don't think I've ever seen a company improve in so many areas in such a short amount of time outside of a bankruptcy process.

CEO Heath Deneke was recruited to SMLP from Crestwood Equity Partners (CEQP, owned in the fund) in late-2019. Heath was the COO of Crestwood and was instrumental in building out their footprint and making them one of the more highly respected G&P companies in the sector. With Summit and Crestwood having several overlapping basins of operation, we were very encouraged by Heath's hiring.

Since Deneke took the helm, the most dramatic change has been with the balance sheet. Management opportunistically repurchased deeply discounted debt, exchanged common for preferred shares, extended maturities and simplified the capital structure. As a result, close to $800mn of fixed capital obligations have been eliminated in 2-years. There's still work to do, but we like the progress that's been made so far.

($ in millions)	2019	PF 9/30/21	*Change*
SMLP			
Revolver	$677	-	*($677)*
ABL Revolver	-	300	*300*
8.50% 2L Bonds	-	700	*700*
5.50% Bonds	300	-	*(300)*
5.75% Bonds	500	259	*(241)*
SMPH Term Loan	162	-	*(162)*
Total Debt	**$1,639**	**$1,259**	***($379)***
DPPO Payable	181	-	*(181)*
Cash	5	16	*11*
Net Debt	**$1,814**	**$1,243**	***($571)***
Preferred	$300	$166	*($134)*
Total	**$2,114**	**$1,409**	***($705)***
Double E (Non-Recourse)			
Bank Debt	*$0*	*$107*	*$107*
Preferred	*27*	*102*	*74*
Total	***$27***	***$209***	***$181***

In early January management exchanged $77mn of preferred shares, including accumulated dividends, for 2.9mn SMLP shares.

Another meaningful, albeit less quantifiable change has been with the corporate structure and governance. For all intents and purposes SMLP is now governed like a C-corp. rather than a Partnership. Private equity sponsor Energy Capital Partners is gone, the General Partner stake was purchased by SMLP and is now owned by LP unitholders, Incentive Distribution Rights have been eliminated, and the board is now comprised of mostly independent directors who are elected by Limited Partners starting this year. Incentives are now fully aligned with LPs.

While I'm not proud of the damage SMLP inflicted on past performance, we aren't in the business of blindly selling positions to avoid the mental anguish of bad memories. We've re-analyzed this one what seems like hundreds of times and re-weighed the risk/reward, the results of which keep it in the portfolio as a smaller position, but one with lots of potential upside.

Happy New Year!

Kristopher P. Kelley
1-25-2022

Disclaimer & Footnotes

This letter is for informational purposes only and does not reflect all of the positions bought, sold, or held by Legacy Ridge Capital Partners Equity Fund I, LP. Any performance data is historical in nature and is not an indication of future results. All investments involve risk, including the loss of principal. Legacy Ridge Capital Management LLC disclaims any duty to provide updates to the information contained within this letter.

This letter may include forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties, assumptions and other factors which may cause actual results and performance to be materially different from any future results and/or performance expressed or implied by such forward looking statements.

Performance for 2018 is provided by Richey May & Associates, our auditor, and was provided via a Performance Review for a separate account that was transferred into the Fund and constituted 100% of the assets of the Fund as of November 1, 2018. Results are net of fund expenses. All performance related figures for the Partnership are unaudited.

Indices are provided as market indicators only. It should not be assumed that any investment vehicles managed by Legacy Ridge Capital Management will, or intend to, match provided indices in holdings, volatility or style. Index returns supplied are believed to be accurate and reliable.

The S&P 500 is a market capitalization weighted index that measures the performance of the 500 largest US based companies. The Russell 2000 Index is a market capitalization weighted index that measures the performance of the smallest 2000 stocks in the Russell 3000 Index and is a common benchmark for smaller companies. The MSCI World Index is a market capitalization weighted index that is designed to be a broad measure of equity-market performance throughout the world. It is comprised of stocks from 23 developed countries and 24 emerging markets.

The AMZ is an index provided by Alerian and measures the return of 32 Master Limited Partnerships on a total return basis. The S&P 500 Energy sub-index comprises those companies included in the S&P 500 that are classified as members of the GICS energy sector. There are currently 28 constituents in the S&P 500 Energy sub-index. The XAL is the NYSE Arca Airline Index. There are currently 14 constituents in the XAL, with most domiciled in the US.

This letter does not constitute an offer or solicitation to buy an interest in Legacy Ridge Capital Partners Equity Fund I, LP. Such an offer may only be made pursuant to the delivery of an approved confidential private offering memorandum to an investor. This reporting does not include certain information that should be considered relevant to an investment in Legacy Ridge Capital Managements investment vehicles, including, but not limited to significant risk factors and complex tax considerations. For more information please refer to the appropriate Memorandum and read it carefully before you invest.