Legacy Ridge Capital Partners Equity Fund I, LP

2022 Annual Letter

<table>
<thead>
<tr>
<th>To December 31st 2022:</th>
<th>LRCP Equity Fund I</th>
<th>LRCP Equity Fund I</th>
<th>S&amp;P 500</th>
<th>Russell 2000</th>
<th>MSCI World Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Net</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trailing 1-yr Total Return:</td>
<td>12.5%</td>
<td>10.4%</td>
<td>-18.1%</td>
<td>-20.5%</td>
<td>-17.7%</td>
</tr>
<tr>
<td>Trailing 2-yr Total Return:</td>
<td>59.5%</td>
<td>46.2%</td>
<td>5.4%</td>
<td>-8.7%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Trailing 3-yr Total Return:</td>
<td>76.4%</td>
<td>59.3%</td>
<td>24.7%</td>
<td>9.6%</td>
<td>17.3%</td>
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<tr>
<td>Trailing 4-yr Total Return:</td>
<td>80.9%</td>
<td>63.3%</td>
<td>64.1%</td>
<td>37.4%</td>
<td>50.2%</td>
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<tr>
<td>Trailing 5-yr Total Return:</td>
<td>73.9%</td>
<td>57.1%</td>
<td>56.9%</td>
<td>20.7%</td>
<td>39.8%</td>
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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.
<table>
<thead>
<tr>
<th>Year</th>
<th>LRCP Equity Fund I</th>
<th>S&amp;P 500 Energy</th>
<th>AMZ</th>
<th>XAL</th>
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<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Net</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>12.5%</td>
<td>10.3%</td>
<td>64.2%</td>
<td>30.5%</td>
</tr>
<tr>
<td>2021</td>
<td>41.8%</td>
<td>32.4%</td>
<td>53.3%</td>
<td>39.9%</td>
</tr>
<tr>
<td>2020</td>
<td>10.6%</td>
<td>9.0%</td>
<td>-33.7%</td>
<td>-28.8%</td>
</tr>
<tr>
<td>2019</td>
<td>2.5%</td>
<td>2.5%</td>
<td>11.8%</td>
<td>6.5%</td>
</tr>
<tr>
<td>2018</td>
<td>-3.8%</td>
<td>-3.8%</td>
<td>-18.1%</td>
<td>-12.4%</td>
</tr>
</tbody>
</table>

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.
RESULTS FOR 2022

Our partnership gained 12.5% gross and 10.3% net of performance fees in 2022.

If you had told me on January 1st of last year that we would gain 12%+ for 2022, I would have been pleased; that’s decent absolute performance over 12-months. If you had told me we’d be up 12%+ while the S&P 500 was down 18% and the NASDAQ was down 33%, I would have been ecstatic. Unfortunately, I of course tracked our performance throughout the year (we didn’t close near our highs), and we fish in a pond that produced some whoppers, none of which we caught. So, there are some nits to pick. As for the former nit, there isn’t much to be done about it; we don’t trade around macro datapoints—a “strategy” that dominates this market—and we never will. There were a lot of crosscurrents last year leading to excessive volatility for our concentrated portfolio, making it painful for the daily observer, but generally par for the course for us. However, the latter nit has cost me a few nights sleep. While we don’t aim to manage a sector fund by any means, Energy is one of the spaces we are highly in tune with and there are companies Nate and I know well that we could have owned, but didn’t, that vastly outperformed our portfolio.

We had a similar outcome in 2021:

“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.” (2021 Letter)

I completely misjudged the positive rate of change in upstream businesses. Russia’s invasion of Ukraine drove commodity prices significantly higher, which caused balance sheets to de-lever much faster than I anticipated, allowing companies to return meaningful amounts of capital to investors. Additionally, management teams continued to talk about capital discipline, which resonated with generalist investors and kept the stocks levitating even as oil and natural gas prices came back to Earth in the 4th quarter. Energy’s weight in the S&P 500 went from 2.7% to 5.2% in a hurry and the big money followed. We suspect this trend continues for a few years as money flows out of technology names and into energy names. And while we do have direct exposure to commodity prices within the fund (through midstream contract structures and through a royalty business we own), it’s relatively small. Additionally, we don’t own any names in the S&P 500 or other major indices. Therefore, stocks that simply benefit from fund flows could continue to have a leg up on us in the short-term.

However, while we know we’ve missed some good opportunities, how we perform in tough markets is more important than how we perform in easier markets. And by that measure we still hold our heads high. Since the founding of the partnership, we’ve outperformed the broader benchmarks in the years they’re negative and have also outperformed our
relevant sector benchmarks in the years they’re negative. We appear to be correlated to nothing. And despite being shown up by Energy indices last year, since 2018 we have outperformed the XLE and AMZ by 21% and 52%, respectively.

5-YEARS IN...

If a successful investment partnership should indeed be viewed as a marathon, we aren’t even a fifth of the way through the course. At this point in an actual marathon our joints should be loose, and our muscles should be warmed up, resulting in more consistent mile times going forward, i.e., the early-race pains should be over. Our partnership is following a similar trajectory and I think we’re starting to hit our stride.

*Philosophically nothing has changed*

We continue to believe that investing in a highly concentrated portfolio focused on sectors we’ve researched and invested in for well over a decade is the best way for us to earn decent long-term returns. Free cash flow and return of capital—supported by stable to improving returns on capital—are the key metrics we look for. We don’t, or haven’t yet at least, used portfolio leverage, nor have we shorted any stocks thus far. Apart from our limited use of call/put options, we have been a plain vanilla long only fund. Cash is simply a function of the opportunity set available and we aren’t afraid of having very little cash on hand, nor are we afraid of possibly having 50%+ of the fund in cash. Simultaneously maintaining focus and flexibility is our goal.

And we are more than happy to grind out returns over the next 20-years as opposed to shooting for the moon over the next 2-years, an approach we feel is appropriate for the environment we’re currently in. While market prognosticators we are not, long periods of flat equity markets have been observed before. For the S&P 500 that includes 1928 – 1952, 1968 – 1979, and most recently 1999 – 2013. Imagine having to wait 22-years for your IRA to get back to even! Each of these dreadful investment periods came on the back of boom times of course, and the latest boom time was one for the history books. Therefore, we think low expectations for the stock market is warranted, and possibly for several years or more.

Our portfolio is built to deliver reasonable returns in such a market. The top three positions comprise just over half of the fund, and while not one of these positions will top Reddit message boards or a CNBC segment anytime soon, we’d be totally comfortable owning each business in its entirety forever, just clipping coupons and reallocating that capital to other ideas. The market does not have to recognize these stocks as cheap and revalue them higher for us to benefit (this is the key point when animal spirits are fizzling, and valuation multiples are declining). The predictability of the capital returned to us as well as the economic relevance of the underlying businesses, is paramount to navigating a turbulent market, and it’s turbulent out there!

As of year-end we were invested in nine different companies, mostly through common equity positions, but also through a handful of call option positions on three of the companies. Two of our companies are less than 5% of assets under management.
combined, (one was sold down for tax reasons and will be repurchased soon, the other is a new position that may very well be substantial this time next year), so for all intents and purposes only seven names matter. The portfolio’s dividend yield is 7.5%, the return-of-capital yield (includes share repurchases) is 10%, the free-cash-flow yield (cash available to equity owners) is 16.5% and leverage is just below 3x EBITDA. Cash is ~10% of fund assets.

Operationally a little has changed
A few things did change in the first couple years of the partnership: I was essentially fired by our first prime broker (not enough trading, not enough AUM), I fired our first outside attorney (he overcharged in my opinion), I terminated my office lease and started working out of my home office (all my kids are now in school, so my house is quiet most days), and I brought in a partner to help, aka, Nate. The failure rate of single-owner startups is much higher than multi-owner startups and I realized why within a couple of years. Having the luxury to bounce ideas off another person as well as divide some of the menial tasks inherent in every small business is vital. It’s been a great decision that has definitively added to fund performance as well as my sanity.

But, outside of those changes, the guiding principle of ensuring incentives are aligned between Limited Partners and the General Partner remains the same. Fund expenses are kept as low as possible and are currently a measly 17bps. The only pass-through expenses we have are for the Fund Administrator and our data platform. Everything else (travel, audit, tax, research literature) is paid for by the General Partner (Nate and me).

Additionally, our fee structure is highly aligned with the objectives of Limited Partners and is simple to understand. We have no management fee, only a 25% performance fee over a 4% hurdle rate. As a result, the General Partner has only been paid 3 of the 5 years the partnership has existed. This type of fee structure is designed to encourage reasonable long-term returns by incentivizing us to avoid the massive drawdowns of capital, and to prevent us from profiting from a growing asset base, regardless of our performance. It’s the opposite of how most of the investment management industry operates, in which performance takes a backseat to marketing and asset gathering.

Jumping on my soapbox...

Of the 1,410 actively managed mutual funds considered in the WSJ’s “Winner’s Circle”, only 40 had positive performance in 2022. That’s a mere 2.8% of active fund managers, and I think it begs the question: why do most of these funds need to exist? Obviously 2022 was a very difficult year to generate positive returns, but even taking that into account, Goldman Sachs estimates only 55% of actively managed large cap mutual funds were beating their benchmarks through November. How can so much money be allocated to managers making millions of dollars a year each (not to mention the firms they work for, the consultants, the administrators, etc.), while they simply hug a benchmark and pretend to be different from one another. I’m sorry, but you’re not a Contrarian if your investors’ best hope is to beat the S&P 500 by 1% in any given year, and even those years are hard to come by.
It seems to me we could do away with 90% of the 1,410 funds, reallocate the capital to a mix of broad indices and actual active managers, and then reallocate the skills of some very smart people to tasks that might actually help improve society. Every single one of these managers has significantly more resources than we do: They pay for all manners of research, they attend numerous industry conferences, they speak with management teams regularly, they have multiple associates building financial models out to the last decimal point, and they hire consultants to do “proprietary” work. Yet the fear of losing their own paychecks prevents them from making the most rational and profitable decisions for their investors.

Nate and I promise this: If we aren’t good, we’ll quit and return everyone’s money. Now figuring out if we’re good isn’t an exact science since an investor can hit a rough patch through no fault of their own, but I think Nate and I are intellectually honest enough to know if there’s a more valuable use of our time and efforts. Neither of us wants the vast majority of his liquid net worth invested in a below average investment fund, and we’re sure you don’t either.

**REVIEW of STOCK REVIEW(S):**

We run a concentrated portfolio and turnover is low, so we do run out of new ideas to talk about at times, but over the past 5-years we have highlighted five positions (one position has been discussed twice). Below is an update on each stock covered, three of which are still owned.

**Enterprise Products Partners, LP (EPD)**

EPD is still owned in the fund and remains one of our largest positions, as it has been since the partnership was founded. This has not been a great investment. Shares are down about 6% since I first wrote about it. However, we have received $8.93 per share in dividends, which is about 34% of the 2018 share price. So, with dividends included we’ve made 28% cumulatively over 5-years. Still not good, but not an impairment of capital either.

Since 2018, EPD’s dividend yield has gone from 6.5% to 8% with the annual per share payout growing from $1.72 to $1.96, +14%. The pace of dividend growth has recently increased from about 2% to 5%+.

Additionally, Distributable Cash Flow per share (what could be paid to us if management wanted to) has increased 22%, from $2.73 to $3.33, while leverage has come down a little over ½ a turn. So, the balance sheet and cash flow metrics are in better shape than they were 5-years ago, and they were pretty good 5-years ago.

The competitive dominance of the asset base, industry leading low leverage, and a founding family with multiple billions of dollars invested alongside us keep it a core holding in the portfolio. We’ll continue to own this company unless the shares become meaningfully overvalued, and if it gets cheaper, we would be very comfortable owning more.
NRG Energy (NRG)
NRG was covered in the 2019 letter with VST. We sold the shares as COVID induced volatility presented better risk/reward opportunities, but never subsequently repurchased shares—as we did with VST. Not only do we think VST is a better value, but the management team at NRG appears to have gone astray. Despite coming to his position during an activist campaign by Elliott Management in 2017, when the prior empire-building CEO was shown the door, the replacement CEO has seemingly embarked on the same failed strategy. In early December they announced the purchase of Vivint Smart Home, a smart home platform company, for $2.8 billion. The transaction diversifies NRG’s business, increases leverage, dramatically reduces intermediate-term shareholder capital returns, and most importantly, is the opposite of what management told us they were going to do when they assumed the role in 2017. The stock fell 15% on the day of the announcement and is down another 5% since then, and now 10% lower than when we first wrote about it. We like the generation business at NRG and the valuation is almost back to interesting, but we’d probably have to see turnover in the C-suite and a refreshed corporate strategy to reignite our enthusiasm.

Vistra Corp (VST)
I sent the 2019 letter on February 10, 2020. VST closed that day at $22.27. As I write in early January the price is $22.30. Now I did say “We would actually prefer it if both (VST & NRG) securities went nowhere for as long possible”—assuming repurchased shares at depressed valuations was our best-case scenario. But A) I didn’t think I’d be that right with respect to “nowhere”, and B) I certainly didn’t think I’d be right 3-years on. Here we are though, with the stock literally going nowhere for the last 3-years. Just like we drew it up!

Management has indeed repurchased 20.3% of the shares outstanding since year-end 2019 and will probably repurchase another 12-15% of the outstanding shares in 2023. My initial assumption was that management could plausibly repurchase 60% of their shares by 2030, leaving them with 200mn outstanding (that assumed shares were appreciating and they had to pay more as the years went on, not what’s transpired so far), but at the current pace of about 50mn shares repurchased per year, they’ll hit that mark by the end of 2026, which would imply free cash flow of $10 per share if the underlying business continues to perform as it currently is. That’s a 45% FCF yield on today’s price. Meanwhile, dividends per share have grown 54% since 2019 and the stock now yields 3.5%, growing about 15% a year. Being paid to wait makes waiting much easier.

We had sold VST shares in mid-2020, replacing some of the position with call options, to free up capital for other opportunities that became available. But when winter storm Uri hit Texas in February 2021 and VST shares went down 20%+, below $17 a share, we rebuilt our common equity position. Today VST oscillates between the biggest and second biggest position in the fund, depending on weekly performance.

DCP Midstream, LP (DCP)
We no longer own DCP. The common equity position was sold in early 2021 and the preferred shares were sold in late 2021 as new ideas surfaced and as the valuation reached
a more reasonable level. As mentioned in the 2020 letter, in the first quarter of 2020 DCP traded down to $2.20 a share as the forced deleveraging of some closed-end funds blindly obliterated midstream stocks. Now Phillips 66 (PSX)—one of the two owners of the General Partner we had highlighted as providing a theoretical floor for DCP shares—is purchasing all the shares they don’t currently own for $41.75. The transaction is expected to close in the second quarter of this year. That’s a 19x return in 3-years for the brave souls who bought at the bottom (not including the $4.68 of dividends you would have received). Not bad!

**Summit Midstream Partners, LP (SMLP)**

A month after discussing Summit in last year’s letter, management provided 2022 guidance and the stock went down 30% that day. Such is the life of an investor in illiquid small-cap securities. Shares are still ~32% below the year-ago price despite results coming in at the high-end of the 2022 guidance range, and despite management selling 2 non-core assets for $115mn at a 15x EBITDA multiple, then subsequently acquiring $305mn of assets at a 4x EBITDA multiple, which should help the company generate $300mn +/- EBITDA in 2023. Most importantly, these transactions were a net positive to leverage ratios. Recent weakness in natural gas prices curbs our enthusiasm a tad, but SMLP is undeniably in a better position than it was a year ago.

Total obligations (including preferred equity and non-recourse Double E debt) have gone from $1.6 billion last year to $1.7 billion today and the EV has gone from $1.87 billion to $1.88 billion, yet EBITDA will be up $75mn+, or 34%. The stock market is valuing the newly acquired EBITDA at 1.3x. Odd. Obviously, leverage is still too high, but with $125mn+ of FCF (that’s a 70% FCF yield) management will continue to work it down.

We estimate SMLP’s year-end 2023 EV/EBITDA is just under 6x while the closest publicly traded peers are valued at closer to 8x. Just closing half of the relative valuation discount is worth $30 a share, on a $17 stock. And the last time SMLP was even close to generating $300mn of EBITDA ($288mn in 2017) shares sold for ~$170 (split adjusted) and the EV was $3.5 billion (about the same amount of debt as today, just $1.5 billion less equity value). The backdrop and sentiment have changed for gathering and processing businesses since 2017, so I wouldn’t expect to get back to those valuations, but with the balance sheet in better shape and corporate governance and corporate structure lightyears better, we’d argue the valuation shouldn’t be half of what it was 5-years ago. Lastly, the CEO, CFO and General Counsel recently forfeited $4.5mn of cash compensation, electing to receive phantom units instead. “That ain’t nothin’”, as a good friend of ours would say, so we continue to own the stock.

We greatly appreciate the support and patience of our partners and we look forward to the next 5-years.

Happy New Year!

Kristopher P. Kelley
1-25-2023
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.

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