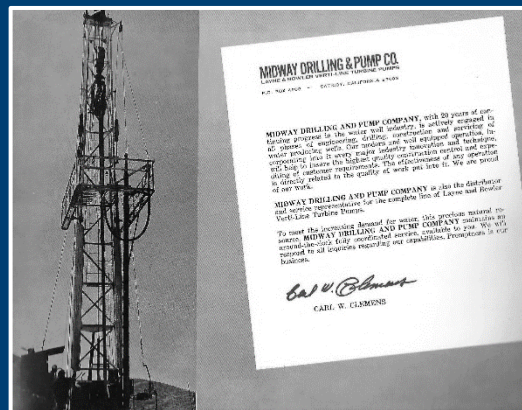
MIDWAY PARTNERS

CAPITAL MANAGEMENT

Midway Partners Capital Management was named after a business that was founded by Jordan Lampos' grandfather and great grandfather, Midway Partners Drilling & Pump Co. It was founded in 1945 and operated for almost 75 years.

While not affiliated or in the same industry, the two businesses share a common set of core values. Midway Drilling & Pump Co. built a reputation of integrity and trust with clients. Midway Partners Capital Management aims to do the same.

The picture shown is a page from the company's 1965 brochure.



MIDWAY DRILLING & PUMP CO.
LAYNE & BOWLER VERTI-LINE TURBINE PUMPS

MIDWAY DRILLING AND PUMP COMPANY, with 20 years of continuing progress in the water well industry, is actively engaged in all phases of engineering, drilling, construction and servicing of water producing wells. Our modern and well equipped operation, incorporating into it every major industry innovation and technique, will help to insure the highest quality construction control and expediting of customer requirements. The effectiveness of any operation is directly related to the quality of work put into it. We are proud of our work.

MIDWAY DRILLING AND PUMP COMPANY is also the distributor and service representative for the complete line of Layne and Bowler Verti-Line Turbine Pumps.

To meet the increasing demand for water, this precious natural resource, **MIDWAY DRILLING AND PUMP COMPANY** maintains an around-the-clock fully coordinated service, available to you. We will respond to all inquiries regarding our capabilities. Promptness is our business.

CARL W. CLEMENS

Re: Year Ending December 31, 2023

Dear Partners:

2023 Performance

The Partnership finished 2023 with a net return of 20.8%. Over the past two years, the Partnership has outperformed the S&P 500 by 1.4% delivering a cumulative net return of 4.7% vs. 3.4% for the broad benchmark[1]. With two full years under our belt, we believe that we have faithfully executed the Partnership's strategy. Going forward the Partnership will continue to focus capital into companies that meet our "quality criteria" and present a margin of safety between the market price and our conservative estimate of intrinsic value.

The table below provides an overview of the Partnership's performance.

Net Return	2023	2022	2-Year Cumulative
Midway Partners[2]	**20.8%**	**(13.3%)**	**4.7%**
S&P 500[3]	26.2%	(18.1%)	3.4%

Note: Individual investor returns may vary given the date of original investment. Historical returns, material market conditions, and investment performance may differ in the future. Past performance is not indicative of future results. Investing in the Partnership includes the potential for material loss.

2023 proved to be a year that few saw coming. In the face of continued inflation, rising interest rates, a banking crisis, and what seemed like ever increasing global conflict, the S&P 500 pushed higher. This was a welcomed rebound from its poor performance in 2022. However, looks can be deceiving.

The bulk of the S&P 500's increase was driven by the price performance of seven large technology-esque companies, dubbed the magnificent seven[4]. These magnificent seven

[1] The Partnership began investing in July 2021. Several months were required to materially invest the cash from initial subscriptions, thus making comparisons to benchmarks less relevant over the beginning months. 2022 and 2023 provide a fully invested comparison. Since inception, the compounded net return of the Partnership is 4.8% versus 5.1% for the S&P 500.

[2] Returns are based on Founders' shares fee structure net of all management fees and expenses. Returns include the reinvestment of investment gains and losses, dividends and interest excluding taxes.

[3] Total index return including dividend reinvestment excluding taxes.

[4] Amazon, Apple, Google, Meta, Microsoft, Nvidia, and Tesla.

companies contributed a return of about 75.0%[5] (or 15.9% on a weighted basis)! The remainder of the S&P 500 constituents contributed about 13.1% (or 10.3% on a weighted basis). Looking back at the magnificent seven's performance in 2022, we see that they were down -39.7% (or -11.3% of a weighted basis) contributing a majority of the S&P 500's loss for the year. It is difficult to believe that the wide volatility in price moves of the magnificent seven over the last two years can be justified by intrinsic value increases and decreases. After all these companies are large, mature, and well followed. The magnificent seven have a market capitalization weighted trailing LTM P/E ratio of 43.6x entering 2024. While they include some great companies with defensible market positions, enviable returns on capital, and opportunities for substantial reinvestment, they are difficult to value. When we make conservative performance projections with discount rates we find acceptable, these market prices appear rich.

Speaking generally, in 2022 and 2023, the hot sectors were energy and big technology-esque companies, respectively. What is interesting is that we have had no exposure to either of these sectors/industries/stocks over the last two years. While we missed out on the hot sectors, we have managed to outperform the S&P 500 over the two-year period. We believe this shows that fundamental intrinsic value matters. Buying a handful of companies that possess our "quality criteria" and are selling at prices below our conservative estimate of intrinsic value can produce satisfactory results. We do not believe that one needs to trade the hot stocks or follow trends/fads to produce satisfactory investment returns over long periods of time.

As evidenced by our lack of investment in the hot sectors, investing based on intrinsic value does not predict which companies or sectors are going to be the price winners in the near term. In fact, it likely does the opposite, and identifies companies that are out of favor from a market momentum perspective. As profits persist, however, value compounds and ultimately pushes up the stock price of these underappreciated opportunities. For example, a company that sees no appreciation in enterprise value can still see its stock price rise as free cash flow is added to its balance sheet and its market capitalization appreciates as a result. Moreover, a company may use its free cash flow to repurchase a meaningful amount of its underpriced shares. The same enterprise value spread across fewer shares will produce a higher stock price.

We do not rely on the market to suddenly or ever "recognize" a company's value after we buy it and drive up the stock price. Nothing is likely to change from the time before we own the stock to the time after we own the stock. We focus on what the cash profits are likely to be in the future and whether the company's managers are likely to make reasonable decisions with those profits as they accrue. We often read investment write-ups that purport to show how a company justifies a higher earnings multiple and thus presents a good investment. It should go without saying that any company that sees its earnings multiple quickly expand is likely to produce great investment results in the short term. While we are happy to enjoy multiple expansion when lucky to experience it, that is not the type of investing returns on which we are placing our bets.

[5] Aggregate market capitalization total return including dividends. Weighted returns are based on market capitalizations at the start of the year.

As of the year ending 2023, about 12.3% of the Partnership's total capital was in cash and equivalents[6]. We do not consider this a traditional hedge, but it does allow us to sleep well at night knowing that we can be opportunistic and aggressive when prices move in our favor as a buyer. With the increases in short-term rates, idle cash now earns north of 5.0%. While we do not time the market, we are looking to invest at the right time, when a securities' price falls meaningfully below our conservative estimate of intrinsic value.

2024 Outlook

As in past annual letters, we make no predictions regarding the economy or the direction of markets in 2024 or beyond. At dinner parties after hearing that we actively invest in the stock market, people often ask us what is going to happen in the coming year. We tell them that we have no idea. This answer typically elicits an eyerolling response. While our lack of premonition or a flashy answer makes us unpopular at dinner parties, we do find it to be intellectually honest. People really prefer predictions in the face of uncertainty even if those predictions turn out to be wrong. The empty space of having no answer is unsettling for most. Not knowing is scary, probably because it sheds light on the fact that we all lack control of the situation. If we made market predictions, they would likely be no better than a coin flip and doubt that others really are either. We prefer to focus completely on the appraisal of individual businesses.

This requires a different kind of prediction. We assess what a company needs to achieve financially in the future to justify its current market price and what it will have to invest to get there. Therefore, we are always forward looking and consider macro- economic changes in the context of specific companies. A few good examples of this are the windfall of profitability achieved in some industries as the economy emerged from COVID-19 in 2021 or the profit squeeze experienced by some companies as inflation drove higher input costs in 2022 and 2023. When appropriate we normalize results to reflect a more conservative view of the future. We do not rely on or extrapolate from operating levels that are unlikely to be sustained. We make these adjustments regardless of the direction of the macro-economic landscape. Trying to explain this distinction doesn't make us any more popular at dinner parties.

Notes on Taxes

It may sound trite, but we believe that the sole purpose of investing is to maximize one's long-term rate of return net of all factors[7]. This means that the strategy that delivers the most absolute cash to an investor over a long period of time wins. It strikes us as odd that one major piece of the cash return equation is wholly omitted from investment performance measures. We are of course referring to taxes.

Taxes are a messy subject. Each investor has a different effective rate and short-term versus long-term gains, as well as a myriad of other factors in the tax code, make any tax calculation

[6] The majority of which is invested in short-term U.S. treasury bills.
[7] As opposed to so-called risk-adjusted returns.

complex. Moreover, some categories of accounts or investor types do not pay taxes[8]. Accountants are paid well to help wade through this swamp.

However, we cannot deny that the impact of taxes can make equivalent returns on a pre-tax basis not so equivalent on an after-tax basis. A tax efficient strategy should be preferred as capital gains benefit from tax deferred compounding which can ultimately leave investors with more cash in their pockets[9]. The selection of investment allocations, managers, strategies, funds, and products might be viewed differently if the taxability of returns were more transparent. Municipal bonds advertise tax-equivalent yields. Why should equity strategies be any different? Portfolio turnover is insufficient on this front.

Going forward, we will provide a note in our annual letters about the basic taxability of our results[10]. If we calculate the percentage of total net gains realized during the period (e.g. the sum of net realized capital gains, dividends, and interest, etc.) divided by the total net gains (realized and unrealized) we should have a taxability factor. This is a simplistic approach and does not account for the specific types of realized gains and losses or other factors, but it can be a reasonable proxy for tax efficiency.

Applying this methodology to 2023, we had no realized net investment gains in total. Put another way, we had no realized net gains (net realized capital gains, dividends, interest, etc.) that were not offset by realized losses. It is important to note that not all types of gains and losses directly offset each other. Taxes may be owed on certain types of gains, while realized losses may offset different types of gains (please see footnote 10 below!). This is meant to demonstrate that the Partnership's long-term compounding strategy is tax efficient. Inevitably, we will realize substantial capital gains, but our goal is to maximize the benefit of tax-deferred compounding. Our pioneering reporting on this front is unlikely to start an industry revolution, but it should be helpful to reinforce how we view after-tax returns. For those investors who don't pay taxes, this may be of little importance.

Portfolio Update

We made a few changes to the portfolio in Q4. We increased our position in Bank OZK (OZK). Early in Q4 the bank was priced at 1.0x - 1.1x tangible book value per share. A bank of OZK's caliber priced at that level provides a meaningful margin of safety. The price rapidly increased toward the end of the year, ending 2023 at about 1.4x tangible book value.

We also increased our position in Legacy Housing Corporation (LEGH). The manufactured/pre-fabricated home builder and lender continues to produce a tsunami of cash flow that it has been efficiently reinvesting back into its lending portfolio at attractive yields. With virtually no stress in its lending portfolio thus far and a squeaky-clean balance sheet, we expect the capital to pile up over the next few years.

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[8]This includes institutional, not-for-profit investors or tax advantaged retirement accounts like traditional 401Ks or IRAs. These retirement accounts defer taxes until future distributions are made.

[9] There is an abundance of 401K literature on this topic.

[10] Tax Disclaimer. This information is provided to illustrate the Partnership's long-term compounding strategy. Nothing contained herein is tax advice. Investors should always consult proper tax professionals.

We reduced our position in Intel Corporation (INTC). After falling dramatically in 2022, the stock rallied in 2023 to near our cost basis. We took the opportunity to reduce and resize the investment. While we continue to believe that INTC is critical to U.S. national security and has a bright future, we must acknowledge that the market for semiconductors is significantly more competitive than in decades past. While semiconductors have always been a cyclical business, we believe that competition is turning the peaks and valleys into smooth hills and deep gorges. The possibility exists that because of competition, INTC can continue to be an important part of the global semiconductor industry and remain critical to U.S. national security without excess returns accruing to shareholders. A smaller position size reflects this possibility.

We never expect to make major changes to the portfolio. Changes will likely happen over a number of years. We have a high bar for any new investments, and they must be more compelling than our existing portfolio. This filter eliminates most opportunities. The bar moves even higher when we consider the tax implications of selling a position that has significantly appreciated. However, if we can find one or two great investment opportunities, we will certainly add them in a meaningful way. We have identified several companies we would like to own and must wait patiently for prices to move in our favor as a buyer.

The portfolio does include several positions that have significantly appreciated in price since our initial investment. It is important to note that we do not believe that price appreciation alone is a reason to sell or trim a position. If we believe that the underlying business continues to build its intrinsic value, we will hold it.

Our portfolio is and will continue to be concentrated. While concentration may produce higher short-term price volatility, we believe it presents the best opportunity to produce satisfactory long-term returns.

The table below provides a snapshot of the portfolio's top investments.

#	Investment	% Capital
1	McKesson Corporation (MCK)	14.0%
2	Bank OZK (OZK)	13.9%
3	Sprouts Farmers Market (SFM)	9.4%
4	Checkpoint Software Technologies (CHKP)	9.2%
5	Investors Title Company (ITIC)	8.0%
6	Legacy Housing Corporation (LEGH)	8.0%
7	Molson Coors Beverage Company (TAP)	7.1%
	Subtotal (Top 7)	**69.6%**
	Other Securities and Derivatives	18.2%
	Cash and Short-Term Treasuries	12.3%
	Total[11]	**100.0%**

[11] May not sum to 100.0% due to rounding.

The Best and Worst of 2023

We want to provide some Partnership highlights for the year that we feel are noteworthy. Let's get the worst out of the way and end on a high note.

<u>The Worst of 2023</u>

The worst of 2023 was our investment in Sleep Number Corporation (SNBR). The stock has fallen significantly and based on the year-end price our current position has about a -72.2% unrealized loss. While this is tough to stomach, it is not what is most disappointing. It is also not the company's current financial position or the management/board's decisions that led to it. What is most disappointing is that there was enough information available at the time of our original investment that should have made us avoid the opportunity. While it is easy to play Monday morning quarterback with all investment decisions, this one was an unforced error and a unfortunate learning opportunity. Let's explain.

SNBR has a great business model. They are a vertically integrated retailer of specialty mattresses. This means they manufacture their own beds and do not sell through third-party retailers. They directly manage 675+ retail stores. They sell a highly differentiated product, the Sleep Number Bed, that provides various features and benefits not offered by traditional mattress competitors. Their direct retail distribution model and ability to grow store count in an efficient manner has led to high returns on capital. The Sleep Number Bed is a premium item, and although they offer lower cost models, the average retail price is about $5,600 per unit.

The company came off a massive sugar high following the pandemic where 2020 and 2021 were outlier years on any measure of revenue, profitability, or return. We did not value the business based on extrapolating these financial levels. We took a conservative look at pre-pandemic averages and applied them to normalize profitability. We fully expected this type of consumer discretionary business to ebb and flow with macro and consumer economic activity, as it has done in prior cycles.

Our mistake was related to our assessment of the management and board's capital allocation decisions. In 2020 and 2021, the company generated a combined total of about $475 million of free cash flow, a pandemic driven windfall compared to previous years. Conservative capital allocation would have been to pay off the approximately $230 million revolver and hold the remaining cash for future opportunities – save for a rainy day. Only the most conservative minded would pay down debt that, at the time, costs so little. SNBR was the opposite of conservative minded.

The decision was made to use the massive cash windfall to repurchase stock. That's not so bad, right? Wrong! The stock price followed the sugar high earnings and shot up to nose-bleed levels. It went from about $50 per share in December 2019 and a market capitalization of about $1.4 billion to a high of about $140 per share peaking in April 2021 at a market capitalization north of $3.5 billion. Remember, this is a company that averaged about $100 million of annual free cash flow prior to the pandemic. In 2020 and 2021, SNBR repurchased a combined $592

million of stock, or $116 million more than the free cash flow windfall over the two years. The average repurchase prices paid were $66.49 per share and $116.80 per share in 2020 and 2021, respectively. At the same time the revolver balance expanded from $230 million at the beginning of 2020 to $383 million at the end of 2021. This is what happens when share repurchases are greater than free cash flow.

With the share price now at about $11.50 per share as of this writing, the company's managers vaporized about $516 million of shareholder capital during their buyback spree. It is hard to understand how they could believe that they were getting a deal on their own stock at an average price of $116.80 per share. Throughout 2022 as operating performance normalized and interest expense rose, the company continued to repurchase stock drawing further on their revolver to do so. Operating performance in 2023 has exacerbated the problem. This has left the company squeezed for cash and in a weak and precarious position.

The disappointment here is that we knew about most of the poor capital allocation when we invested. We began buying shares in early 2022 as the stock price had fallen more than 60% from its highs. We became fully aware of the damage once the 2022 annual report was released. We gave management the benefit of the doubt that they would change course and become better stewards of shareholder capital. The saying "a leopard never changes its spots" comes to mind.

On a positive note, the investor group Stadium Capital Management LLC launched an activist campaign in mid-2023. Their letter to the company's board of directors highlighted many of the issues noted above. The campaign resulted in the addition of two new board members. We welcome the influence of new rationale, shareholder minded board members.

It is not difficult to read the tea leaves of capital allocation. The lesson here is that past actions speak louder than words. If something is an investment non-starter, the benefit of the doubt need not apply.

The Best of 2023

The best opportunity we saw in 2023 was created by the banking crisis that began in early March with the collapse of several banks, namely Silicon Valley Bank and Signature Bank and later the acquisitions of First Republic by JPMorgan Chase and Credit Suisse by UBS Group AG. While weakness at these institutions likely warranted their collapse or acquisition, other banks and financial institutions saw their equity prices fall as fear moved through the sector. Investors tend to use a shotgun approach when panic selling. However, not all banks are created equally. There are significant differences in how banks make investments on the asset side of the balance sheet and how they fund those investments on the liabilities side of the balance sheet. We believe that many banks by the nature of their structure are likely to experience several years of depressed earnings as the cost of their liabilities increases faster than the return generated by their assets. Until banks with long duration fixed loan books can reprice, refinance, or materially grow their loan portfolios, they are likely to under earn as Net Interest Margins (NIM) are compressed by rising deposit and wholesale funding costs.

Amid the wreckage, we increased our position in regional bank, Bank OZK (OZK). About 75% of OZK's loan book is floating rate, so while the Federal Reserve waged its war on inflation by raising short-term rates, the rate of return on OZK's loan book increased in lockstep. As a result, OZK has not experienced a compression in profitability. In several quarters, it saw NIM increase as its loan book repriced faster relative to deposits.

When looking at OZK's asset portfolio from a credit perspective, we rely on its long history of lending expertise. Many perceive OZK to be more risky than others because a significant portion of its portfolio are construction loans. OZK has consistently experienced lower charge off rates than industry peers. Even at the peak of the 2008-2010 financial crisis, OZK's credit quality significantly outperformed the industry. We view construction lending as a specialty market that requires significant expertise. Underwriting knowledge, decisions, and discipline combined with sponsor relationships create barriers to entry for competitors. The proof is in the efficiency ratio pudding. OZK has averaged an efficiency ratio of about 35% over the last two years while most banks are happy to run at 55-60% (for efficiency ratios, lower is better!).

Prior to the release of this letter, OZK reported its 2023 financial results. We are happy to include a few of the highlights:

- Record Q4 net income available to common stockholders;
- Record diluted earnings per common share for the year;
- Return on average tangible common stockholders' capital of 17.5%;
- Increased tangible book value per common share to $36.58 from $31.47, or 16.2% for the year;
- Paid a dividend of $1.42 per common share; and
- Reduced the weighted-average diluted shares outstanding by 3.8%.

On the January 19th 2024 conference call, Chairman and Chief Executive Officer, George Gleason made the following comment, "And in my 45 years as CEO, we've never lost money in a single year because we just don't do things that don't make sense to us when we do them."

We looked at FactSet data going back to 1997 (as far as we can easily go back in the software) and verified that they have indeed not had any years of negative net income available to common shareholders' over that period. It is also interesting to note that in 1997 the tangible book per common share was $0.57. Based on the tangible book value per common share of $36.58 at the end of 2023, this represents a 17.4% compounded annual increase over 26 years. We would argue that Mr. Gleason's capital stewardship should go down as one of the greatest track records in history.

Purchasing such a business at 1.1x tangible book value per share provides a large margin of safety to our conservative estimate of intrinsic value.

It should be easy to see why OZK is one of our top two positions.

Conclusion

The Partnership is well positioned for 2024 and beyond. Our largest investments are in growing companies with competitive advantages that produce significant free cash flow. They have capital efficient business models that do not require leverage. We feel that their competitive advantages provide the opportunity for continued financial success long into the future. If they remain on the path, we will let them compound.

We are actively looking to add to our holdings in 2024 and stay on the lookout for great opportunities. As recent history shows, the public equity markets are sure to serve a few great companies at attractive prices throughout the year. We will be waiting.

Please contact JL@midwaypartnersllc.com for more information about the Partnership. Midway Partners Capital Management also offers separately managed accounts.

As always, we are honored that you have chosen to trust Midway Partners Capital Management with your hard-earned capital.

Sincerely,

Jordan Lampos

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There are substantial risks in investing in securities of the partnership and each investor must have the financial ability, sophistication, experience, and willingness to bear such risks. Parties should independently investigate any investment strategy or manager, and should consult with qualified investment, legal, and tax professionals before making any investment decisions. An investor should not make an investment unless the investor is prepared to lose all or a substantial portion of its investment. There is no secondary market for the interests nor is any expected to develop.

Interests in the partnership have not been registered under the Securities Act of 1933, as amended, in reliance on registration exemptions thereunder. The partnership is not registered as an investment company under the Investment Company Act of 1940, as amended, in reliance on exemptions thereunder. The Investment Manager is exempt from both state and federal registration as an investment adviser and accordingly is not registered as an investment adviser in any state or with the Securities and Exchange Commission.