Old West Investment Management, LLC

July 11, 2023

Dear Investor,

As we cross over the halfway mark of 2023, the stock market has staged an impressive rebound from the steep losses of 2022. Of course, it's a bit misleading to refer to the stock market as the S&P 500. What has been coined the "magnificent seven," seven tech stocks were responsible for the vast majority of the index's gain this year. Apple, Microsoft, Alphabet, Nvidia, Amazon, Meta, and Tesla were up on average 85% in the first half. The NASDAQ was up 32%, the best first half since 1983. Of course, this comes on the heels of a 33% loss in 2022. These stocks all benefited from the term "AI," something most people had never heard of two years ago. AI is not new as many companies have benefited from it for more than 30 years. The constant mention of it recently on quarterly conference calls is amusing and is very reminiscent of the Dotcom craze of 20 years ago. On the recent Kroger conference call, the CEO mentioned AI eight times. Mind you this is a supermarket chain, and there was zero mention of AI on their previous call.

As you can see from your enclosed statement, the Old West portfolios clearly underperformed the major indexes in the second quarter, but when compared to the Russell 2000 small cap index or the equal-weighted S&P 500, we compare much more favorably. Our three- and five-year numbers are still some of the best in the country, and we are poised to have a great second half of the year.

A major risk for the market going forward is interest rates. Yes, the Fed has drastically raised the Federal funds rate to 5%, but a more powerful force will be massive debt issuance by countries all over the world. The U.S., China, Japan, and every country in Europe will be issuing record amounts of debt over the next several years, putting tremendous upward pressure on rates. Since the lifting of the debt ceiling in the U.S., our national debt has risen to $32 Trillion. Our treasury will need to issue more than $600 Billion of debt by year-end, and more than $1.7 Trillion in 2024 to cover deficit spending. That begs the question who will buy all this paper? Traditionally the Chinese and Japanese were big buyers of our debt, but their finances have worsened, and we can no longer depend on them. This would result in higher rates for longer. If you can earn 5% buying short-term Treasuries, you might think twice before adding money to the market.

The overall market continues to be very expensive. The market cap to GDP ratio, known as the Buffet Indicator, is currently 172%, 20% higher than what it was in the 2000 tech bubble, and 44% above the historical average. The big seven tech stocks are mostly priced for perfection, with limited upside and significant downside risk. Apple, the world's biggest company, recently crossed over the $3 Trillion market cap. Few investors realize that Apple's revenue and profit have fallen year-over-year. No doubt it is an amazing company, but trading at 33 times earnings with negative growth, the valuation is very stretched. Many investors believe we are in a new bull market after rebounding from last year's decline. They should be warned that from 2000 to 2002 there were a dozen double-digit rallies averaging over 20%. We could very well be in the middle of a bear market rally where all of this year's gains are reversed. At Old West, we are fully prepared for that possibility.

The prospects for the market depend on the health of the economy, and there are a few warning signs to be wary of. We hear that Americans have trillions of dollars in savings, but I believe that is misleading because the bulk of that is in the hands of the wealthy, which are a minority. Half of all Americans could not come up with $500 for a one-time emergency. Another stress point will be the student debt situation. The June 3 debt ceiling agreement calls for the resumption of debt payments on the $1.6 Trillion of student debt outstanding. Some 43 million Americans will once again start paying on average $390 per month. There goes that new iPhone!

The great thing about being a value investor is you're realistic about economic projections and valuations. I go to bed at night with one eye open, as there is no shortage of potential "black swans" out there. Preserving your capital is job number one. Having said that, our portfolios are full of terrific ideas with great upside potential.

You never know where you might find a new investment idea, and one of my favorite sources of new ideas are friends and clients that I consider experts in their fields. Our client list includes executives in biotechnology, real estate, heavy equipment, agriculture, construction, professional sports, entertainment and more. A friend and client is in the multifamily real estate business, AKA apartment buildings, owning hundreds of luxury units. He called my attention to a young, fast-growing company, SmartRent, whose products increase efficiency and reduce costs for the property owner. His biggest complaint is the product is so popular he's having difficulty getting supply. We began investing in the company over one year ago and decided to write about it in this quarterly letter. It's a bit unusual for us to invest in a money-losing growth company, but it's about to become profitable and we find the idea very exciting.

SMARTRENT, INC. (SMRT)

SmartRent is the leading smart home technology company focused on rental housing in the U.S. Multifamily owners and operators love their products which include smart access keyless entry, water leak detection and smart thermostats/climate control. They also offer self-guided tours for prospective tenants to see units, resident and staff management software and parking flow optimization. Based in Scottsdale, AZ, the company sells hardware devices and software that generates recurring revenue as they monitor their services.

At Old West, we are always looking for great owner/operators of companies to partner with. Lucas Haldeman founded SMRT in 2017 after serving as CTO at Colony American Homes, at the time a large owner of single-family rental homes. It was in that role that he realized the need for technology solutions to provide more efficient property management. Haldeman owns $15 million of SMRT stock, ranking him as the company's largest shareholder.

Over the past five years SMRT has attracted the top multi-family operators in the country as customers, including the top seven apartment REITs. Invitation Homes, the largest owner of single-family rental homes, is one of SMRT's 500+ customers. As far as competition goes in this space, SMRT has said they have more units deployed than all their competitors combined.

SMRT is rapidly riding the road to profitability. Revenue grew by 53% from 2021 to 2022 and forecast to grow by 43% in 2023 to $240 million. Gross and net margins continue to improve, and CEO Haldeman has repeatedly said they will be EBITDA positive by this year-end. The company has $200 million of cash on its balance sheet with no debt. SMRT went public in April 2021 as a SPAC at $10 per share. The share price quickly went to a high of $14 and then like most SPACs, dramatically fell to a low of $2.15 per share. Our average cost is $3.70, and it currently trades at $3.82. The market cap is $762 million, and the $200 million of cash equates to $1.00 per share.

To give you an idea of their growth potential, SMRT has installed 600,000 units and there are 45 million rental units across the U.S., and with no serious competition today it's going to be exciting to watch SMRT grow.

Thank you for your continued loyalty and support. We look forward to growing your hard-earned money the balance of this year and beyond.

Sincerely,

Joseph Boskovich, Sr.
Chairman and Chief Investment Officer