June 2, 2022

Dear Fellow Investors,

Adestella's main fund lost less than 1% in the first quarter of 2022. Long holdings fell 5.9%; these were fully offset by 6% gains from the short book, but the strengthening dollar was an 80 basis point drag that pushed us just below breakeven. Domestic stocks, which tend of comprise the bulk of our short positions, outperformed versus the less-hedged international ones. Given the long-short performance spread this quarter, long-only accounts generally fared worse, with losses in the range of 5-8%.

Rampant inflation and the expectation of more restrictive monetary policy to combat it dragged down markets over the period. The S&P had its first losing quarter since Q1 of 2020, as well as its first correction since the start of the pandemic. Meanwhile, corporate bonds had their worst quarterly decline since 1980, while US treasuries had their worst showing since record-keeping began in 1973. On the flipside, traditional inflation hedges such as commodities and precious metals saw broad gains and helped insulate our portfolio from these headwinds to some extent.

As always, an updated performance summary is included at the end of this letter.[1]

The Tide is Out

I keep a watchlist of companies I would like to buy if they were to ever reach a reasonable valuation; to monitor them, I often set an alert that is triggered if the stock falls below a certain price. At that point, I revisit the company and see whether the risk-reward has reached a level where it could potentially make sense as an addition to the portfolio. These alert emails often go months without showing up in my inbox, until all of a sudden, in the span of a few weeks, a slew of them all come in at once.

The latest wave is now here— in recent weeks, there have been more new alerts than at any time since the start of the pandemic. Anecdotally, it appears that we may have reached a point of some capitulation and liquidations, as there are now frequent occurrences of strange trading action, such as outsized moves relative to the market or any fundamental developments. We now have more compelling ideas than space in the portfolio, so our biggest challenge now is trying to decide which to prioritize, and in which cases it may make sense to sell something else we like, even at a depressed price, in order to fund something even better. There were many candidates for positions to discuss this quarter; a few of the ones I find most interesting are included below.

[1] Note that due to an increasing number of long-only accounts (which of course have a different makeup from the core long-short strategy), as well as the newly-required existence of an entirely separate set of accounts for European clients following Brexit, it has become difficult to distill composite performance into a single number. To avoid these complications and maintain consistency, going forward I will report the performance of the main fund. This does not make a material difference on the table values shown below; the cumulative net difference in performance between the two reporting methodologies was 0.11% at the end of Q1 2022.

Discussion of Selected Positions

Signet Jewelers (SIG): In my last letter, I discussed the addition of a few commodity stocks that could potentially serve as hedges in an inflationary, higher interest rate environment. One other sector that has presented similar opportunities is brick-and-mortar retailers, many of which are available at low-to-mid single-digit earnings multiples. Such deep value names tend to do well during periods of rising interest rates, as their firm value is comprised mainly of near-term cash flows that are less sensitive to investors' discount rates. Of the wide swathe of candidates, my current favorite of the group is Signet—a jewelry retailer that owns many famous brands whose commercials you have probably seen in the past, including Kay, Zales, and Jared.

The jewelry/watch market is currently just a GDP-grower, but the industry is highly fragmented. For SIG, the ability to leverage its size for pricing discounts and for funding a wider range of add-on services (such as repair, extended service, and rewards) helps create a compelling value proposition relative to independent shops. The company has also invested heavily in moving from retail-only to omni-channel, and the reception seems to be positive thus far, with eCommerce penetration going from 5% to 23% in just a few years while delivering higher than expected sales retention.

As everyone knows, much of brick-and-mortar retail has been threatened by the eCommerce giants. However, the jewelry market's size and growth are modest relative to other potential targets, and the specifics of the niche (such as the importance of "eye test" qualities like shine and significant shipping insurance costs[2]) are not particularly attractive to digital-native players. As such, it is not surprising that Amazon's efforts to date have been modest. Many of the standard information fields in its listings fail to provide the specifics that jewel buyers are looking for (for example, ranges in color and clarity are often given instead of exact values), while comparisons of like quality between Amazon listings (which are only from 3rd party merchants) and peers actually suggest they are not price competitive currently.

While jewelry is generally a high-ticket item that tends to be sensitive to changes in consumer spending power, in SIG's case this is partially offset by gold/silver content as inflation hedge and purchases that are either "event-driven" (such as wedding rings, for which decision is driven by timing rather than price) or made by individuals with significant disposable income (as its products are primarily viewed as accessories) that are generally less price sensitive.

Management seems to have a reasonable vision and has executed competently on it so far. Since fiscal 2020 (which ended in Jan. 2020, and is thus a pre-pandemic figure), SIG has increased same store sales by 35%, while GAAP operating income and EPS are up 80% and 56%, respectively. Over the same period, the company also cleaned up its balance sheet and now sits in a net cash position, despite closing a sizeable acquisition during the period.

Despite this progress, shares still trade at a valuation suggesting a dying business. SIG recently guided for $12.25-13 in EPS for FY23 (ending January), which works out to a P/E multiple of less than 5x at current prices. Management is taking the right steps to try to capitalize on the discount, authorizing an

[2] Signet, on the other hand, generally utilizes buy-online-pickup-in-store.

accelerated repurchase program alongside an 11% dividend increase. Meanwhile, 12% of the float is being sold short, for which I can find no explanation beyond the simple "brick and mortar is dead" idea.

Given the exhaustion of pent-up demand following the end of pandemic lockdowns, most expect the jewelry industry to be roughly flat for 2022. The midpoint of SIG's guidance suggests 3% growth, which is hardly awe-inspiring, but also not bad in the context of a mid-single digit industry decline. Furthermore, much of this appears to be already priced 4.5x earnings, and there is also potential upside to what has historically been conservative guidance (SIG has beaten estimates 7 of last 8 quarters).

Should Signet continue on its current run-rate, it could earn its market capitalization in cash within four years. Given it operates in an industry that has demonstrated incredible staying power over time, and given management performance to date, I'm betting that's attainable. I don't know what the right multiple is for this business, but in my view 5x is much closer to a floor than a ceiling. In 2015, SIG traded at 20x earnings, which was well after the time by which the eCommerce threats were already universally known. If the company makes progress in taking share and continues to build a track record of returning capital to shareholders, I don't think 10x earnings (a PEG of less than one on both a trailing five and ten year basis) is unrealistic. Such a multiple would likely produce a stock price of around $120 in two years, representing a 40% IRR from here.

InMode (INMD): Following months of steady declines, we are seeing stocks once labeled "growth at a reasonable price" now more accurately described as "growth at a cheap price." One such example is InMode, which is a relatively recent (albeit slightly too early, in hindsight) addition to the Adestella portfolio. InMode is an Israeli medical device company whose machines are primarily used to perform ablative treatments, which are minimally invasive procedures used to destroy abnormal tissue. Ablative treatments are expected to grow at a 11-14% CAGR in the next five years, driven by increasing preference for minimally invasive treatments and growing patient populations. With a current market size of $7.5 B (and an expected $16 B by 2028), there is plenty of whitespace ahead for a firm with LTM revenues of $378 M. 30% of existing customers have already purchased multiple machines, and consumables revenue is the company's fastest growing subsegment, so further penetration within the current installed base also seems likely.

InMode possesses many of the characteristics of a high-quality business. It has high gross and free cash flow margins, requires only modest amounts of capital expenditure, and generates 40% returns on capital. End market demand is generally non-cyclical, and its balance sheet is clean. The business is diversified both in the type of platform sold (hands-free and non-invasive are about 30% of revenues) and in geography (34% of total sales outside the US). Insiders still own 12%, and the company has a history of repurchasing shares and recently authorized another buyback.

Why does the opportunity exist? At highs of the year, the stock was trading at premium multiples that reflected significant optimism about future prospects. As general growth bullishness has waned, many such former high-flyers have experienced large declines in their share prices; INMD is down 76% from 52-week highs. But unlike many other fallen angels, INMD actually has consistent profits and cash generation. I would imagine much of the recent investor base would have been largely composed of medical innovation investors, many of whom may have been forced to pare back exposure following a miserable run in the last six months. Such investors were likely also over-indexed to biotechnology, which was the worst performing sector in 2021 and is off to a terrible start for 2022 as well.

I also found an old short seller report from early 2020, which essentially made two arguments. The first was that revenues were not high quality, driven by "significant discounting and aggressive financing terms." This has clearly been debunked, given that INMD has increased those revenues from $156 M at the report date to $378 M in the LTM period, with growth actually accelerating in 2021. The second, more concerning claim centered on failed procedures that left patients with burns and scars in some instances. The unfortunate reality, though, is that no medical procedure is zero risk. There are now around 600,000 laser resurfacing treatments a year, while the latest study I can find identified 174 serious injury cases over a 27-year period. Even adjusting for procedure growth in recent years, this is something close to a 0.001-0.002% rate. Even if we assumed there were a significant number of unreported cases, the incidence would still be far lower than the broader outpatient procedure rates of just under 1%. These handful of cases receive all the attention (especially if you're a short-seller with an angle), but the truth is that the vast majority have no complications, leading to mostly satisfied customers. Safety should always be the top priority for a medical device provider like INMD, but the truth is that all the evidence suggests that their machines are every bit as safe as those of peers.

Furthermore, an investor today is well-compensated for these risks, as the company is trading at a single-digit EBIT multiple despite having compounded it at 74% since 2018. Even assuming significant deceleration from recent years, one can pencil out meaningful upside here. If InMode can produce 10-15% growth at margins near their current levels – which management (historically conservative guiders) seems confident in achieving – it should generate around $200 M in GAAP EBIT for 2023 assuming no additional buyback authorizations. A lower multiple is warranted given the step-up in tax rates INMD faces in the years ahead, but the current 9x is overly punitive given INMD's margin profile and balance sheet. A basic sensitivity analysis is included below, suggesting a range and skew of outcomes that are decidedly in our favor even with modest assumptions.

INMD 2023 Estimates	Low	Mid	High	Notes
Sales	453.6	463.4	483.0	<-- low assumes 8% growth on 2022 guidance low-end, mid takes current consensus est., high assumes 15% growth on midpoint of 2022 guidance
x EBIT Margin	40.0%	42.5%	45.0%	<-- reflects GAAP margin; was 47% in 2021, guidance assumes around 45% for this year
EBIT	181.4	196.9	217.4	
x Multiple	9.0	13.0	17.0	<-- 9x is current; positive-EBIT peers are around 13x; median since IPO is 19x
EV	1,633.0	2,560.3	3,695.0	
- ND	(698.4)	(698.4)	(698.4)	<-- adds interim est. FCF less cash for repurchases
MC	2,331.3	3,258.7	4,393.3	
/ Shares	85.7	85.7	85.7	<-- assume buyback only sufficient to offset dilution
Value	27.20	38.02	51.26	
Upside	6.7%	49.1%	101.0%	$ 25.50 current price
IRR	4.0%	27.2%	52.3%	

XPO Logistics (XPO): XPO is a name we've owned and done well on before. Now we've come for another bite of the apple, this time with more of a special situation angle. Much of what I wrote in 2020 still applies today – XPO is well positioned to benefit from increased demand for outsourced supply chain solutions, and it has the scale and technology advances required to continue taking share from peers.

Most importantly, it has a management team that understands capital allocation and has a history of unlocking shareholder value via corporate actions. The company's latest moves are twofold: a planned spin-off of its freight brokerage business, and a divestiture of its European business and North American intermodal operations.

The first move, the spin-off, will separate two businesses with very different capital intensity profiles. Remaining at legacy XPO will be the less-than-truckload (LTL) operations, where XPO is a national leader with one of the largest networks and lowest operating ratios in the industry. This business is benefiting from a firm pricing environment and a long-term tailwind from eCommerce penetration, and management sees further company-specific opportunities to further enhance profitability and growth independent of macroeconomic conditions. The SpinCo will house the asset-light brokerage operations, which is mainly comprised of its XPO Connect digital platform that matches carriers with shipping customers. This segment has grown revenue at a 27% CAGR over the last 8 years – more than three times the industry rate – and continues to gain share in what is still a very fragmented industry. The second action, the divestitures, refocus XPO's operations on its core North American businesses while also accelerating its deleveraging process; following the two transactions, XPO will go from its prior 2.7x net debt/EBITDA to a net cash position.

Given the separations, a SOTP approach is the obvious valuation choice. While XPO is also considering a stock listing for its European operations, for simplicity we will assume the segment is simply sold – my value is based off reported valuation ranges. The intermodal sale has already been completed and proceeds reflected on the balance sheet, so I do not include it here. In the analysis below, I include a conglomerate discount, but this should collapse once the various transactions are finalized. The assumptions below lead to a $100 target price, which suggests almost a double from here. XPO (following its prior spinoff) traded in the $90s last summer during a time of much greater market optimism, so I don't think it's unreasonable value; in fact, further upside is possible if the pure-play operations are indeed awarded higher multiples as independent entities.

XPO SOTP

Segment	Metric	Metric Amt.	Multiple	Segment Value	Notes		
LTL	LTM EBIT	697	12.5	8,712.5	<--SAIA & ODFL average is 12.7x		
Brokerage	LTM EBIT	226	13.4	3,028.4	<-- CHRW mult. is 12.6x; ECHO taken private at 14.2x		
European Operations	PE valuation	4,500	1.00	4,500.0	<-- company only breaks only revenues by geography; rumored sale price in Oct. 2020 of $4-4.5 B, assume high end as business is now larger		
			EV	16,240.9			
			- ND	2,555.0	<-- as of 1Q22		
			MC	13,685.9			
			/ Shares	116.0			
			Value	117.98			
			x SOTP Discount	85.0%		15%	discount
			Price Target	100.28			
			Upside	79.1%		$ 56.00	current price

Outlook and Conclusion

Q1 was volatile for both the market and the Fund, and thus far Q2 has been the same way. April marked the worst month for some major indices since 2008, and our portfolio was not spared. But that is only problematic if results are judged on a short-term basis; in our history, while the overall outcome has been good, a large portion of our gains have come in relatively short bursts of time following similar periods. We cumulatively underperformed in the market from 2015 to 2016 in the midst of the Greek debt default and Brexit, but rebounded to gain over 40% in 2017. In Q1 2020, we were down 23% for the year in March, yet by December had not only recovered those losses, but ended up with a 90%+ net gain. I don't know when we will be rewarded for our patience, but the worst thing we could do would be to panic and risk missing out on the next of these bursts. We all would have liked for it to happen by now, but one must accept that Mr. Market's schedule sometimes has odd hours. In the meantime, we will continue to try to take advantage of many of these watchlist opportunities that have recently been marked down. I thank you all for your partnership and hope everyone reading this has a great summer.

"He who knows only his own side of the case, knows little of that."

- John Stuart Mill

Per Ardua Ad Stella,

Andrew Jakubowski

Performance Summary:

	1Q 2022	Since Inception
S&P 500	-4.6%	167.3%
Vanguard Total World Stock ETF	-5.5%	93.2%
Russell 2000	-7.5%	88.6%
HFRI Equity-Hedge (Total) Index	-4.3%	58.5%
Adestella Investment Management[3]	**-0.7%**	**237.9%**

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[3] As discussed in Footnote 1 above, this value reflects the performance of the Adestella Rigel Fund.