LVS ADVISORY

Investment Results	Full Year 2019	Full Year 2020	Year-To-Date 2021	Since Inception[1]
LVS Growth Portfolio (net of fees)	**-**	**61.8%**	**30.8%**	**111.6%**
Benchmark: S&P 500 Total Return Index	-	*16.3%*	*15.9%*	*34.7%*
LVS Defensive Portfolio (net of fees)	**7.0%**	**13.2%**	**4.4%**	**26.4%**
Benchmark: Barclays High-Yield Bond Index	*13.4%*	*5.0%*	*3.1%*	*22.8%*

Note: investment performance is presented net of all fees and expenses. Investment results are as of July 2, 2021.

(1) LVS Defensive was incepted on January 1, 2019. LVS Growth was incepted on January 1, 2020.

July 6, 2021

Dear Investors,

With the first half of 2021 in the books, I am pleased to report satisfactory results for our two investment strategies.

The Growth Portfolio has continued to benefit from the bull market in stocks and the economic recovery. We have had a handful of stocks in our portfolio nearly double year-to-date, including one stock that has more than tripled. At the same time, many of our holdings have not moved much at all so far this year. The benefit of investing with a semi-concentrated portfolio of 20 stocks is that we have enough exposure to each individual security to materially benefit from the upside of the winners. At the same time, we are sufficiently diversified such that not all of our investments move together at the same time.

The Defensive Portfolio has been more sluggish this year which can be explained by 1) the deflation of the SPAC bubble and 2) the tough environment for bonds and other high-yield asset classes. Last summer we purchased many SPACs for less than the value of their cash holdings. By the end of 2020, many of these SPACs saw their share prices inflate to unreasonably high levels. During the first half of 2021, the prices reversed and SPACs now trade back at levels that reflect the value of their cash. We have been gradually selling our SPAC holdings over the course of the last year.

I commented on the tough environment for yield-driven asset classes in the prior investor update. Rising inflation expectations combined with a record year for mergers & acquisitions have resulted in a robust opportunity set for merger arbitrage. We have used the cash generated from selling our SPAC investments to re-position the Defensive Portfolio to focus on merger arb. I am optimistic for how the back of the year will play out.

I will spend the rest of this note discussing our investment in Avid Technology (NASDAQ:AVID) which is the largest current holding in the Growth Portfolio at an 11% weight. Not only do I believe it is worth sharing why Avid is our largest position but I also believe the story behind how we came to invest in the stock is illustrative of how our research process works.

Avid Technology overview

Avid Technology provides creative software and hardware to professional video and audio content creators. On the video side, Avid Media Composer is the industry standard for professional video editing in broadcast television and Hollywood films. On the audio side, Pro Tools is the industry standard for recording and editing audio in professional music studios. The key distinction is that Avid focuses on the high-end content market. If you see something on YouTube, it probably was not made with Avid but if you see something on TV or Netflix or listen to something on Spotify, it was most likely created with Avid tools.

The company also sells hardware used to record, edit, and store media. In professional video, this primarily consists of high-fidelity storage devices used to manage extremely large video files. In professional audio, Avid sells studio equipment such as input/output devices and control surfaces. Hardware is lower-margin and only accounts for one-third of the company's revenue but is strategically important because it locks-in the customer base. The competition generally focuses on either hardware or software. That Avid has best-in-class solutions for both is a competitive advantage.

Pictured above: Avid S6 for in-studio mixing and Avid VENUE for live music production.

Avid's dominance in high-end content creation is rooted in the company's history. Bill Warner invented non-linear video editing (NLE) software in the 1980's and founded Avid Technology to commercialize these tools with the TV and film industry. Originally, the company sold a hardware workstation for tens of thousands of dollars that had the software built-in. This was an integrated workstation designed for the high-end market and only large-scale professional studios could afford it.

By the mid-1990's Avid's non-linear editing system was widely adopted by the entertainment industry. Film studios and broadcasters heavily invested into Avid's hardware solutions by placing the equipment in their physical studio environments and editing bays. Film schools began teaching on Avid because it was widely known that if you wanted to be a professional editor, you needed to be proficient in Avid. In 1995, Avid acquired Digidesign which expanded the company into professional audio and provided the Pro Tools software suite.

Avid enjoyed near total industry dominance for 20 years until Steve Jobs decided to disrupt the creative software industry in the early 2000's when Apple began selling its video editing software Final Cut for just $500. Having served as the Chairman of animation studio Pixar, Steve Jobs was passionate about the film industry. He also believed that making creative tools more accessible on Mac could help Apple sell more computers.

Final Cut was not only a good editing software, it was available for a fraction of the price of Avid Media Composer which still sold for thousands of dollars. Apple took over the low and mid-end of the video editing software market overnight. TV and film studios stuck with Avid though because they were already heavily invested in its ecosystem with physical hardware and storage devices.

Steve Jobs was really the force behind Apple's push into creative tools and when he passed away in 2011, Final Cut lost much of its prior focus and attention. The last major release of Final Cut Pro was in 2011 and it has been supported with updates but by most accounts, it has failed to keep up.

Adobe has largely filled the void left by Final Cut over the last 10 years with its Adobe Premiere and Adobe After Effects software. Adobe has poured resources into making these editing tools feature-rich and easy to use. Importantly, when Adobe transitioned to a SaaS subscription model in 2012, it began bundling its video tools with its photo and website editing tools. Within a few years, virtually every creative professional had access to Adobe's video editing software at little to no incremental cost if they already had access to Photoshop.

Today, Avid continues to dominate the high-end market and counts more than 8 in 10 film and TV studios as customers. Avid also continues to win in high-end audio with more than 7 in 10 professional music studios and audio engineers counted as customers. However, Avid has lost its place in the low-end video market with less than 10% share. It has fared better in low-end Audio with 40% share but competitors including Apple's Logic and Ableton Live have gained a footing.

Business model transition and product innovation

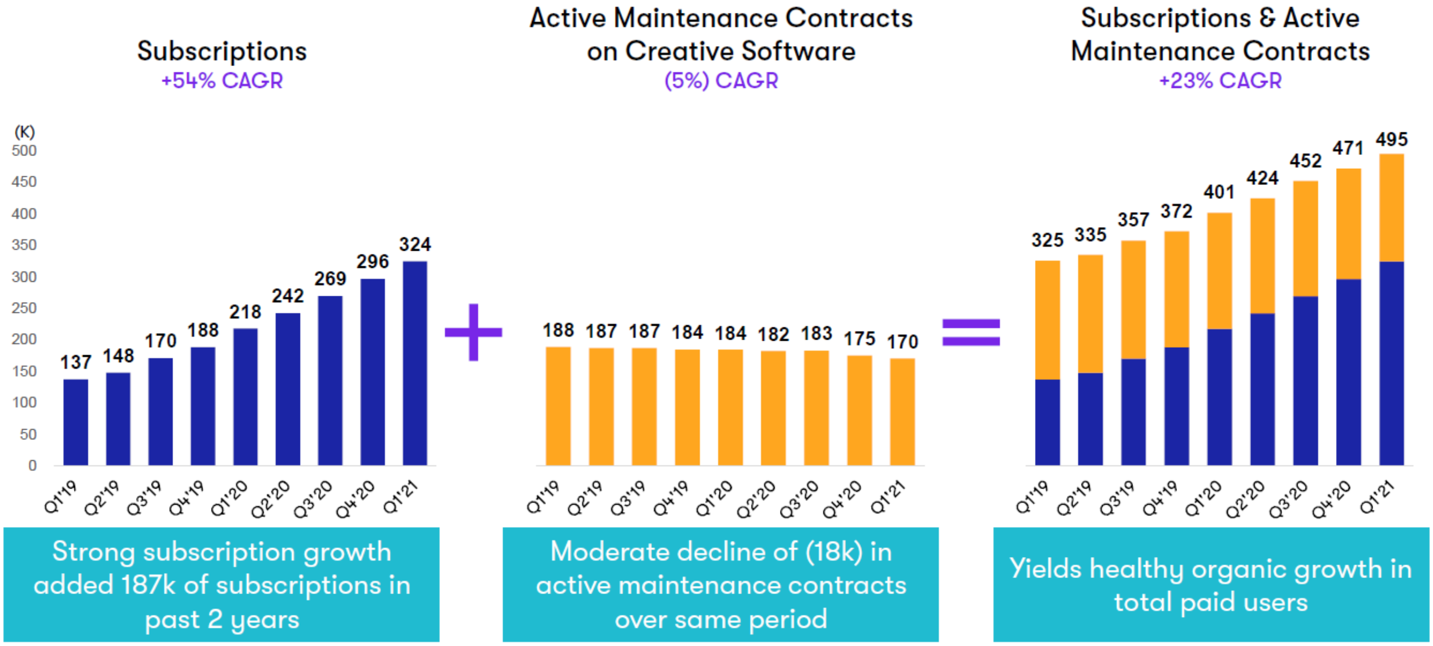
In keeping with the times, Avid began offering a subscription-based version of its creative software in 2014. Instead of paying $600 for a full license of Pro Tools, a user subscribes for roughly $30 per month. Avid also created a free tier with basic features and the option to upgrade to a paid version for more functionality. At first, Avid offered both the subscription offering and the full-licensed offering to customers but the licensed version of the software has been phased out in the last year.

This business model transition unlocks value in three ways:

1) The free tier and monthly paid subscription plan lower the cost of adoption for users, allowing the software to get into as many hands as possible.
2) A recurring subscription increases the lifetime value of customers because customers that do not churn end up paying more for the software over the total period of use. Also, a captive subscriber base is more likely to buy additional products and premium features.
3) A recurring subscription product is higher-margin than packaged software because it requires less product development costs to maintain, less marketing spend per user because existing customers do not need to be repeatedly sold, and better enables a direct-to-consumer sales channel.

The shift to subscription has started to play out but still has a ways to go. Avid now counts more than 324,000 paid subscribers. It has 170,000 users who pay for maintenance contracts that will convert to the subscription product over time. Additionally, the company has over 500,000 active users that have paid for a licensed version of Media

Composer or Pro Tools within the last few years but are not on a subscription plan or maintenance agreement. In other words, Avid can triple its paying subscriber base by simply converting its existing users.



Source: Avid 2021 Investor Day presentation.

Cloud adoption is another major trend that Avid is innovating around. The company has established a partnership with Microsoft Azure to enable customers to leverage workflows in the cloud. Bringing the professional video and audio industry into the cloud is not straightforward. The file sizes for high-resolution films are inexplicably large, there are dozens (sometimes hundreds) of individuals who need access to collaborate, and there are significant security concerns with the risk of content being stolen or leaked, to name a few issues.

However, moving workflows to the cloud can be more efficient if managed properly. It also better enables remote work which has become an important capability for all types of companies. One good indicator of the potential demand for Avid's cloud solution is that Disney has signed up as an early customer.

Avid not only wants customers to use the cloud for file management, it is also intent on having applications run natively in the cloud. Avid's Edit On Demand is the first full-featured video editor that runs on a web browser and can access and edit ultra-high definition media files from anywhere in the world as long as there is a good internet connection. For the reasons discussed above, this isn't an easy product to stand up – it is exponentially more difficult than running Microsoft office in the cloud for example – but it shows the direction that Avid is moving towards.

On the audio side, Avid's Pro Tools already enables remote work and cloud workflows. Musicians can record music remotely with an engineer using Pro Tools and use Avid Link to share files in a cloud-based file manager.

Finally, Avid is pioneering a new HD audio format for recording music. Avid has a strategic partnership with Dolby Atmos which allowed Pro Tools to be the first audio editing tool to create and edit files in this new "immersive audio" format (Note: immersive audio is sometimes referred to as "spatial audio" and is an advanced form of surround sound). Dolby Atmos is gaining traction. Apple recently announced that it is bringing the new audio format to its Apple Music service starting June 2021. As part of this initiative, Apple and Dolby will be doubling the number of Dolby-enabled recording studios – this investment will directly benefit Avid.

Moving to a subscription software business model was a savvy move that is already resulting in improved unit economics and accelerated growth for Avid. But pushing product innovation such as new editing features, cloud workflows, and media formats is equally important because it forces customers to subscribe to the latest version of Avid's software. If you are a professional audio engineer, you need to use the latest version of Pro Tools to work with Dolby Atmos. If you are a Hollywood film studio and want to enable distributed workflows, moving to a cloud or hybrid cloud environment and purchasing Avid subscriptions is the quickest and easiest way to do that.

We initially passed on investing in Avid

We starting looking into Avid during summer 2020 as we were intrigued by the business model transition. Despite a relatively detailed analysis of the company and conversations with investor relations, we were unable to get comfortable with an investment at the time.

The biggest question mark we had was on the underlying health of the customer base. At the time, film sets and music recording studios were closed. The TV broadcast industry was expected to face a big hit from a drop in advertising revenue and cord-cutting. It was unclear when movie theaters and concert halls would ever reopen. Essentially, the ways that Avid's customer base have historically made money were all being threatened and there wasn't a light at the end of the tunnel as to when the situation would get better.

Avid also didn't have a good balance sheet. As of March 31, 2020, Avid had $171 million in net debt on annual Adjusted EBITDA of $47 million. This was 3.6x net leverage heading into a period of significant uncertainty and disruption in its end-markets.

Finally, we recognized that Avid was an industry leader and an innovative company but questioned how sustainable Avid's competitive advantage was given Adobe's aggressive investment and a somewhat crowded field in the audio tools space.

At $10 per share, we concluded that Avid was a cheap stock but that it was cheap for very good reasons. In retrospect, this was a huge mistake.

Speaking with customers gave us conviction

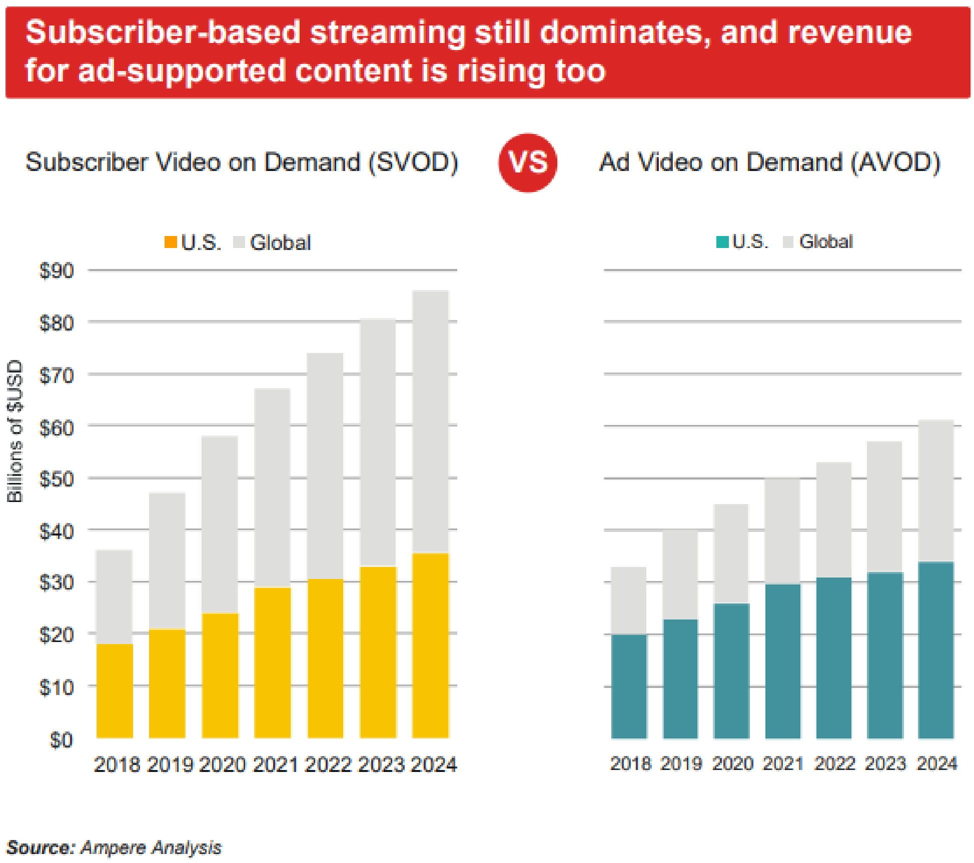
At the start of 2021, we became interested in the film production industry. Streaming services like Netflix and Disney+ were huge beneficiaries from the Covid-19 pandemic and were rushing to invest in new content, which benefits a few publicly traded content production companies.

Upon studying the film production industry, it became apparent that the pandemic was actually a boon for the professional content creation industry and was not the Armageddon we feared when we first looked at Avid.

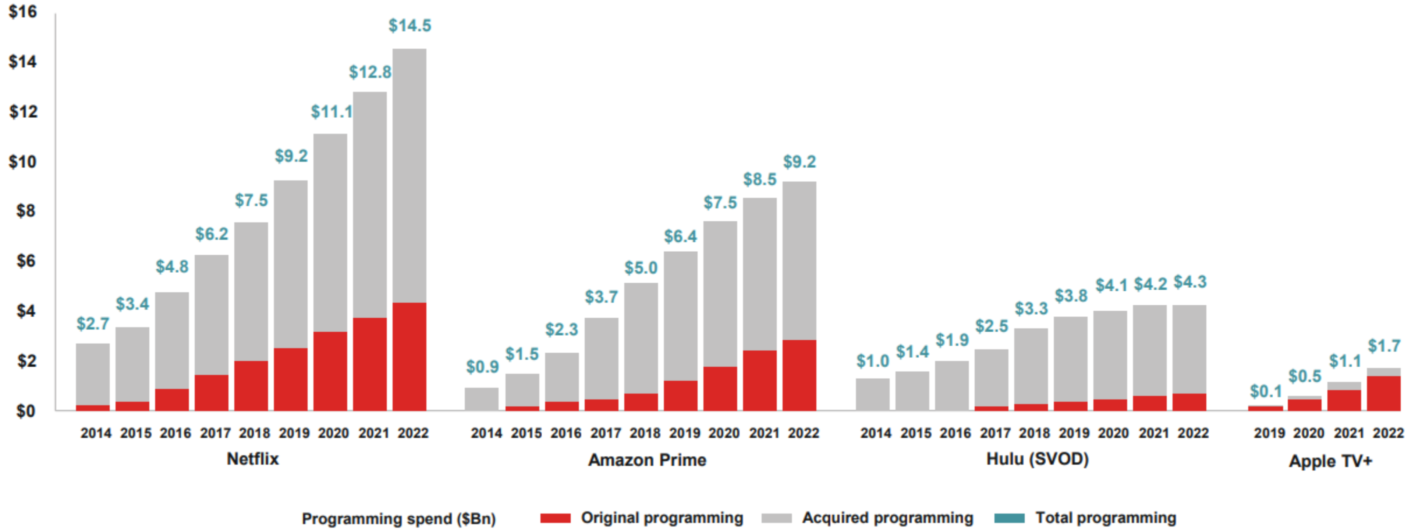
One of the film production companies we studied was Thunderbird Entertainment (TSX:TBRD). Thunderbird is a content supplier to all of the major streaming services and noted in its Q2 2021 earnings call that customer bids for its content tripled from 2019 to 2020 and that its pipeline was fully booked for several years. The company has had to hire hundreds of new employees to meet customer needs and has simultaneously reduced its physical real estate footprint because employees want to remain remote even after the pandemic subsides.

We spoke to Thunderbird's management team who noted to us that they use Avid tools on every project. They have had to significantly increase their spend with Avid because of the ramp in content production and the need to enable work from home. Thunderbird described shifting their expense structure away from physical real estate to free up more resources to invest in IT tools including cloud adoption. We spoke to a few other industry insiders who echoed the same themes as Thunderbird.

The pandemic has accelerated a shift towards streaming services and the rapid growth is expected to continue for many years. Video streaming industry revenue is expected to grow more than 50% over the next 5 years on top of the bump realized in 2020.



All of the major media companies including the legacy players have pivoted to serving this fast-growing market. There is a rush to outspend the competition on content in order to attract the most subscribers. This has been referred to as "the streaming wars" and it is still heating up.



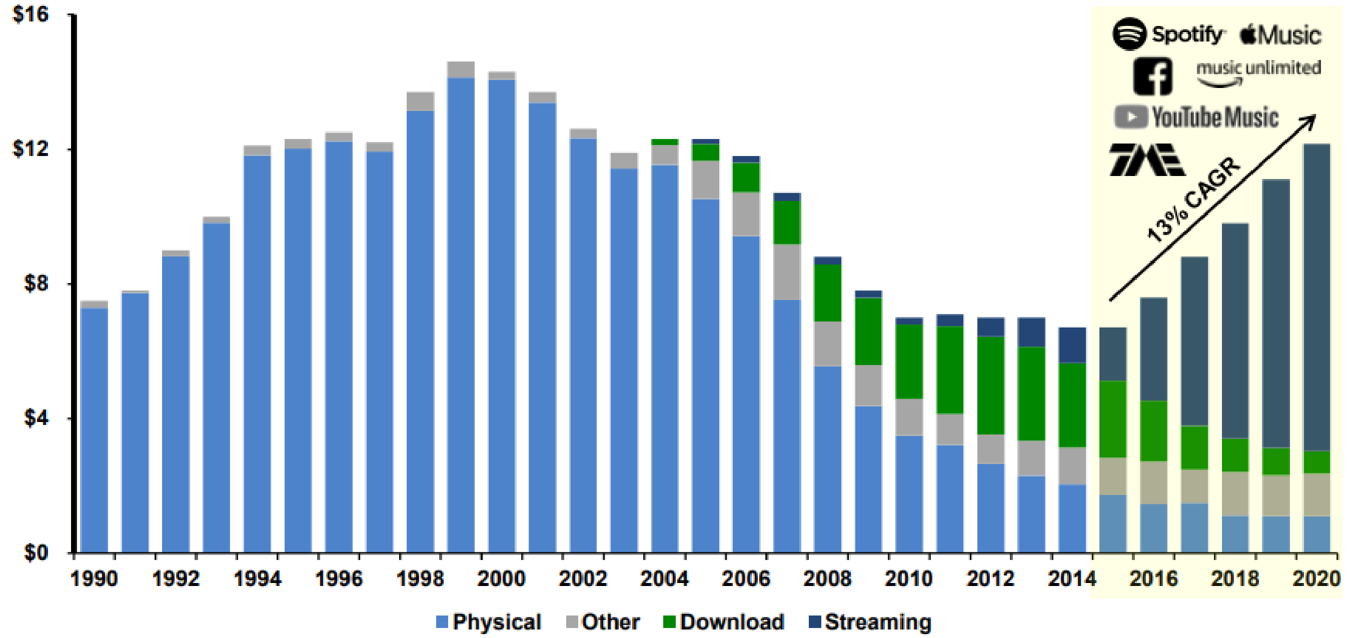
Note: Reflects estimates for programming cost amortization instead of cash content spend. Total programming expense for Netflix represents estimates from RBC Capital Markets internet analyst Mark Mahaney for 2020 - 2022, with the mix of original / acquired programming derived from SNL Kagan's forecasts.

Source: SNL Kagan, RBC Capital Markets estimates

When Discovery and Warner Media agreed to merge in May 2021, they noted that the additional scale provides the combined company the ability to spend even more on content than they otherwise could if they were separate entities. Normally when large competitors merge, they harp on how much costs they can cut to justify the merger. It is very telling that they believe spending more on content is a key selling point of the deal.

There is a similar phenomenon occurring in the music industry where customers have embraced streaming services such as Spotify and YouTube Music. The major record labels are now earning nearly as much money as they did before Napster disrupted the industry in the early 2000's. And in order to capture the current and future generations of music listeners, the major record labels are continuing to invest in new artists.

U.S. Recorded Music Industry Revenue ($bn)



Source: RIAA. Note the US industry revenue trends are consistent with global trends over the same period

Essentially what we learned is that the new way of doing business in the professional content industry has created a thriving ecosystem for Avid's customers. The legacy media companies have largely embraced the new mediums and are investing in technology to meet customer demand. With the benefit of an additional year, we can also see the light at the end of the tunnel for a return to movie theaters and concert halls.

Another positive development was that Avid has been able to refinance and pay down its debt load. As of March 31, 2021, Avid carried net debt of $129 million and net leverage of 1.8x. This is down from 3.6x net leverage just one year prior. Much of the improvement is due to the growth in cash flow stemming from highly profitable software subscriptions, despite a rough year in other segments of the business.

Finally, we gained much better insight and comfort with the competitive landscape after speaking to customers. To boil it down to the most salient point: Avid is the only company that provides enterprise-grade software and hardware to the high-end content market. Also, Avid Media Composer vs. Adobe Premiere or Avid Pro Tools vs. Ableton Live are false choices. Most customers in the high-end market purchase all of these tools because each one has particular features or capabilities that it is best at. It is primarily in the mid and low end of the market where customers choose one software over another.

After updating our analysis, we purchased shares in Avid Technology in March 2021. Our purchase price was significantly higher than where the stock traded when we first analyzed the company but the investment has still worked out so far.

Why we're bullish from here

In the short time we've owned Avid the stock has nearly doubled. The sensible thing to do would be to sell it and find another under-valued stock to buy instead, right?

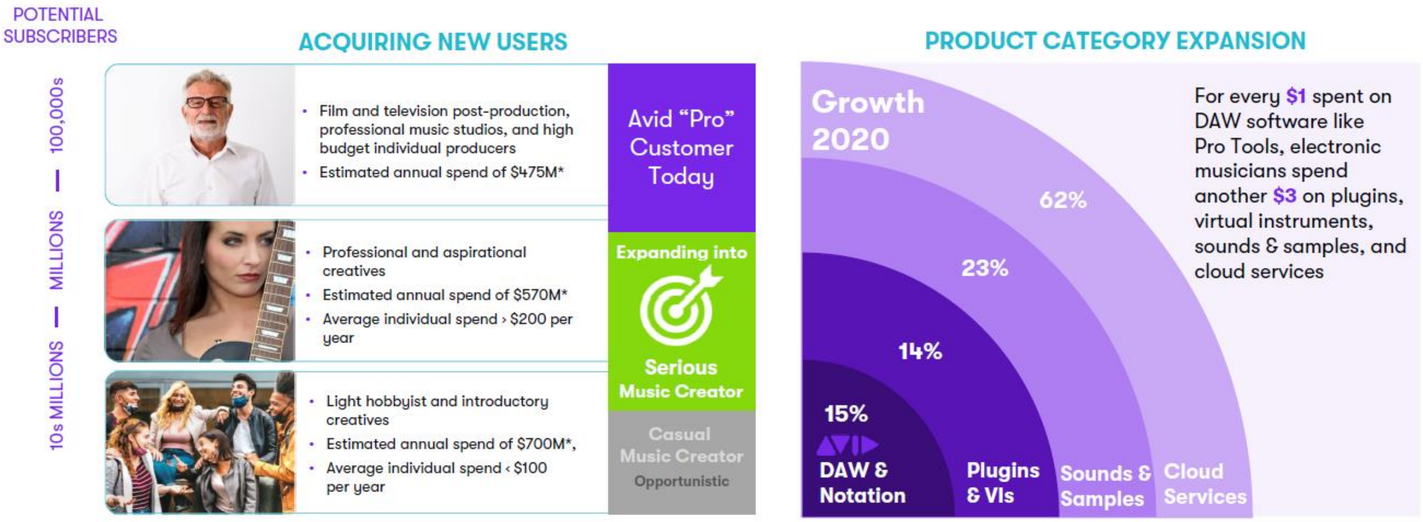
We are just as excited today about our investment in Avid as we were in March when the stock price was much lower. This is mostly because we initially underestimated just how attractive the current tailwinds are for the business. While the company's valuation has nearly doubled, our expectations for long-term growth and cash flow generation have also increased.

In addition to executing the transition to a subscription model and upselling customers to cloud workflows, Avid has incremental investment opportunities to expand its total addressable market by going after the mid and low end customers and selling additional features to existing users.

Avid owns the high-end of the video and audio markets but the mid and low end of both markets is an order of magnitude larger in terms of the number of potential users. The company has estimated that the middle-tier "prosumer" market (corporate videos, aspirational music artists, etc.) has 10s of millions of users, and the lower-tier "hobbyist market" (social media influencers, enthusiasts, etc.) has 100s of millions of users. Avid has roughly 1 million users today (500k paying users).

Avid has not focused on growing outside of the high-end market since Apple disrupted the industry, but at its most recent analyst day in May 2021, the company laid out a game plan for penetrating new market segments. Avid intends to use its enhanced cash flow position to reinvest in customer acquisition and go after this opportunity to sell more creative software subscriptions. While it is not guaranteed to succeed, we believe it can generate strong returns on its marketing spend and more than double its user base in the coming years.

The company also hinted at an interesting opportunity to expand into tangential products through M&A or organic investment. For example, the average Pro Tools user spends $3 on additional plugins, virtual instruments, and cloud services for every $1 they spend on Pro Tools. Avid is well-positioned to acquire these third-party services, make them exclusive to Pro Tools, and capture the incremental growth opportunity through a "land and expand" strategy. There are also incremental niches in video such as color correction that Avid could expand into.



Our valuation math on Avid is straightforward. The company has disclosed a 2025 free cash flow per share target of $3.75, that implies an 11x multiple based on the current share price. Software peers Adobe and Autodesk trade for 40x free cash flow today, if Avid executes on its financial targets and is valued at a 30x cash flow multiple, then the stock will triple over the next 5 years.

However, Avid's long term projections appear conservative. The company targets hitting $375 million in subscription software revenue by 2025. Assuming a $30 monthly average revenue per user, that target implies a little over 1 million paying subscribers. Avid can hit that target by simply converting its existing user base to the subscription model. If Avid is successful in acquiring customers from the middle and lower-tier segments of the market, it could easily exceed 2 million paying subs.

There is no way to know with precision how much Avid will grow or how profitable the company will be five to ten years from now, but we have conviction that Avid is operating in an attractive and fast-growing industry. The management team has done an excellent job navigating Avid through its business model transition over the past 6 years and we are encouraged by the incremental adjustments to the strategy that are being made. We have a rough sense of what we think Avid could be worth in the future and are hopeful that we will need to keep adjusting those assumptions higher over time.

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Until next time

Thank you for your continued support and interest in LVS Advisory. I hope everyone stays safe and enjoys the rest of summer.

Best regards,

Luis Sanchez

Luis V. Sanchez CFA

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