LVS ADVISORY

Investment Results	2019	2020	2021	2022	2023	YTD 2024	Since Inception[1]
LVS Event-Driven (net of fees)	**7.0%**	**13.2%**	**9.1%**	**3.8%**	**6.2%**	**0.0%**	**45.6%**
Benchmark: High-Yield Bond Index	*13.4%*	*5.0%*	*4.0%*	*(11.4%)*	*12.5%*	2.3%	26.3%
LVS Growth (net of fees)	**-**	**61.8%**	**16.1%**	**(35.8%)**	**7.0%**	**18.2%**	**52.5%**
Benchmark: S&P 500 TR Index	-	*18.4%*	*28.7%*	*(18.1%)*	*26.3%*	15.3%	81.7%

Note: investment performance is presented net of all fees and expenses. Investment results are as of June 30, 2024.
(1) LVS Event-Driven was incepted on January 1, 2019. LVS Growth was incepted on January 1, 2020.

July 23, 2024

Dear Investors,

During the first half of 2024, the LVS Event-Driven Portfolio was flat and the LVS Growth Portfolio gained 18.2%, net of all fees and expenses.

After a difficult Q1, the Event-Driven Portfolio regained some ground in Q2. The opportunity set for merger arbitrage is improving. According to PWC, the value of deals in H1 2024 is up 22% over H1 2023 in the Americas. In addition to increased M&A activity, deal spreads are wide, providing attractive return opportunities. The regulatory environment is still challenging, but we have made some adjustments to avoid deals with elevated regulatory uncertainty. As I discuss below, we have also found success investing in non-merger situations.

The Growth Portfolio continues to generate strong performance. I am particularly pleased with our performance because we do not have exposure to Nvidia (or any semiconductor company for that matter). Nvidia alone accounted for one-third of the S&P 500's first half performance. Our portfolio looks very different when compared to major indices like the S&P 500 or the Russel 2000. Our differentiation not only produces solid returns but also provides diversification from passive asset allocations.

Event-Driven Portfolio & Growth Portfolio: Talen Energy Investment

This quarter I will discuss an investment we made in Talen Energy (NASDAQ:TLN). Talen is the only stock we own across both our Event-Driven and Growth Portfolios.

Talen Energy is an unregulated power generator whose primary asset is a 2.2 gigawatt nuclear power plant located outside of Berwick, PA. The Company also owns an additional 8.4 gigawatts of mostly natural gas powered plants in the Mid-Atlantic region.

Susquehanna Nuclear Power Plant

Talen's Bankruptcy

The investment story for Talen begins with the Company's 2022 bankruptcy. Talen was a debt-strapped private-equity backed company with a sprawling power generation portfolio. In addition to managing a complex capital structure, the company maintained a hedging strategy to protect itself from a sudden drop in energy prices. Ironically, Talen wasn't protected from a sudden *rise* in energy prices.

When the war in Ukraine broke out in Spring 2022, natural gas prices soared. Talen was short natural gas futures, as a hedge, and was stuck with a large short-term financial loss requiring it to post collateral at the exchange. Talen was unable to post collateral and instead filed for bankruptcy protection.

The Event-Driven Thesis

Post-bankruptcy restructuring situations tend to be good hunting grounds for investments because you can often find otherwise good companies married to bad balance sheets. After shedding liabilities that made a company insolvent, opportunistic investors are often able to buy restructured assets at attractive prices. To take this idea further, I believe Talen is a better business today than it was pre-bankruptcy.

The bankruptcy process allowed Talen to clean up its balance sheet by converting debt liabilities to equity capital. Talen also restructured its hedging program so that it no longer would need to provide collateral in the case of energy market volatility. In a stroke of luck, Talen no longer needs to hedge its nuclear power generation at all because the Inflation Reduction Act introduced a tax credit scheme that protects nuclear power plants when electricity prices fall. The combination of the new hedge program and the nuclear power tax credits has fundamentally transformed the asset/liability profile of the company.

Talen's new management team resolved a pragmatic strategy for Talen 2.0. First, divest non-core assets including the Texas energy portfolio, a data center shell, and a bitcoin mining project. Second, regain a mainstream equity listing by uplisting from the illiquid over-the-counter market to the Nasdaq. Finally, return excess capital to shareholders while maintaining a conservative leverage ratio.

The event-driven investment thesis was quite attractive. Talen traded at a discounted valuation to more established nuclear peers such as Constellation Energy (NASDAQ:CEG) and had a number of catalysts to unlock value for investors. I learned about the situation in February 2024 and made our initial investment at ~$69 per share.

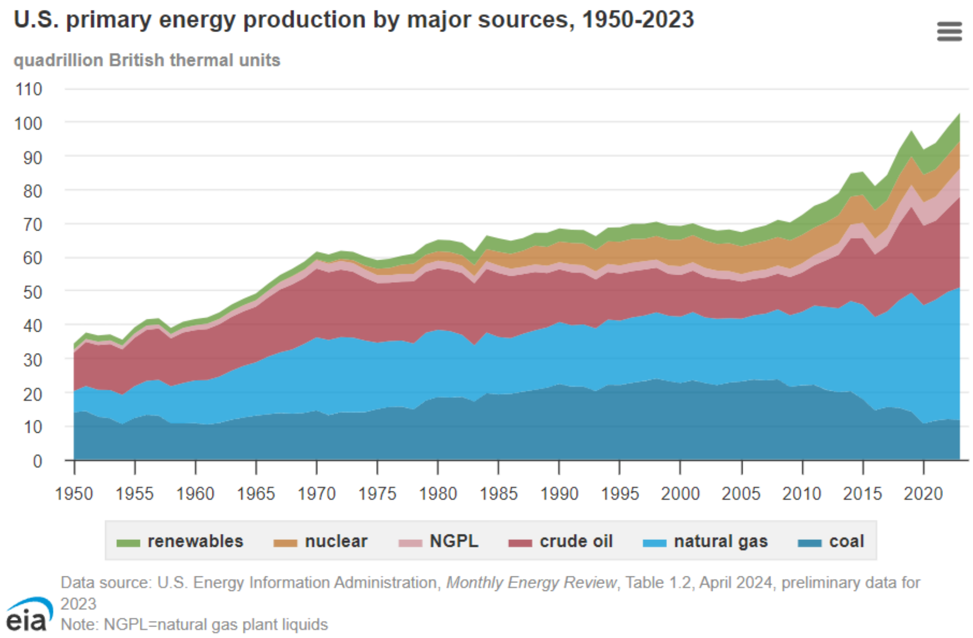
The Bull Case for Nuclear Power Generation

Approximately two-thirds of Talen's revenue is generated from its massive dual unit nuclear power plant. The more I learned about the prospects for nuclear power, the more bullish I became. There are strong trends in both energy supply and demand that support the fundamentals for existing nuclear power producers.

Beginning with the supply argument: nuclear power plants are a highly valuable and scarce asset.

Nuclear power plants are valuable because nuclear is the only source of carbon-free energy that is reliable enough to be considered "base load energy". Other sources of reliable energy are either dirty (fossil fuels), are not yet reliable (solar, wind), or are not abundant (hydro, geothermal).

The US has agreed to phase out coal and other dirty power sources over time. Coal used to account for one-third of power generation but now accounts for roughly 10%. This supply gap has largely been filled by natural gas and crude oil (see below chart). Nuclear was previously vilified as a dangerous source of electricity; however, politicians on both sides have become much more pro-nuclear in recent years as an increasingly attractive alternative. This has led to a number of nuclear plant extensions, talks of restarts, and new tax incentives.



Nuclear power is scarce because it is extremely costly and timely to build. Almost all US nuclear reactors were built between 1967 and 1990. Regulatory costs skyrocketed after the Three Mile Island accident in 1979. The Vogtle electric plant in Georgia was the only new nuclear plant added in the last 30 years. Vogtle took 15 years and $30 billion to build (after coming in over 2x budget). Nuclear power plants just aren't economically viable relative to the cost of building new natural gas plants. However, this makes existing plants, like the one Talen owns, more valuable.

Moving on to the demand argument: electricity demand growth is accelerating as the US adopts electric cars and builds more data centers.

Electricity demand has historically grown in-line with population growth; however, recent technology shifts have accelerated the demand on the grid. Artificial intelligence applications are more compute intensive and therefore require more electricity. For example, ChatGPT uses as much as 30x more electricity per query than Google search. Research from the Boston Consulting Group projects data center energy use in the US will 3x from 130 terawatt hours in 2022 to 390 terawatt hours by 2030.

Regional power regulators have sharply increased their demand growth forecasts. PJM, the regulator for 13 states in the Northeast and Midwest, projected 5 year demand growth of 2.6% in 2022 and *nearly doubled* its forecast one year later to 4.7% growth.

The strong demand growth for electricity bodes well for Talen's non-nuclear plants as well. All electric utilities stand to benefit from greater utilization and higher electricity prices in the coming years.

The Long-Term Growth Thesis

The Growth Portfolio has fundamentally different underwriting criteria than the Event-Driven Portfolio. For Event-Driven, I am primarily looking for hard catalysts to unlock value combined with strong downside protection. On the other hand, the Growth Portfolio invests in high-quality assets with long-term earnings growth potential. The Venn diagram typically doesn't overlap because the types of companies with transformational catalysts are usually challenged or under-managed which is why they need to be restructured or sold.

Talen is an exception for several reasons.

First, there is a wide moat around the business simply because a new nuclear power plant of Susquehanna's scale cannot be replicated at a cost anywhere near the current enterprise value of Talen. Furthermore, nuclear power plants operate with high margins and limited operational complexity. These are the attributes of a very high-quality asset.

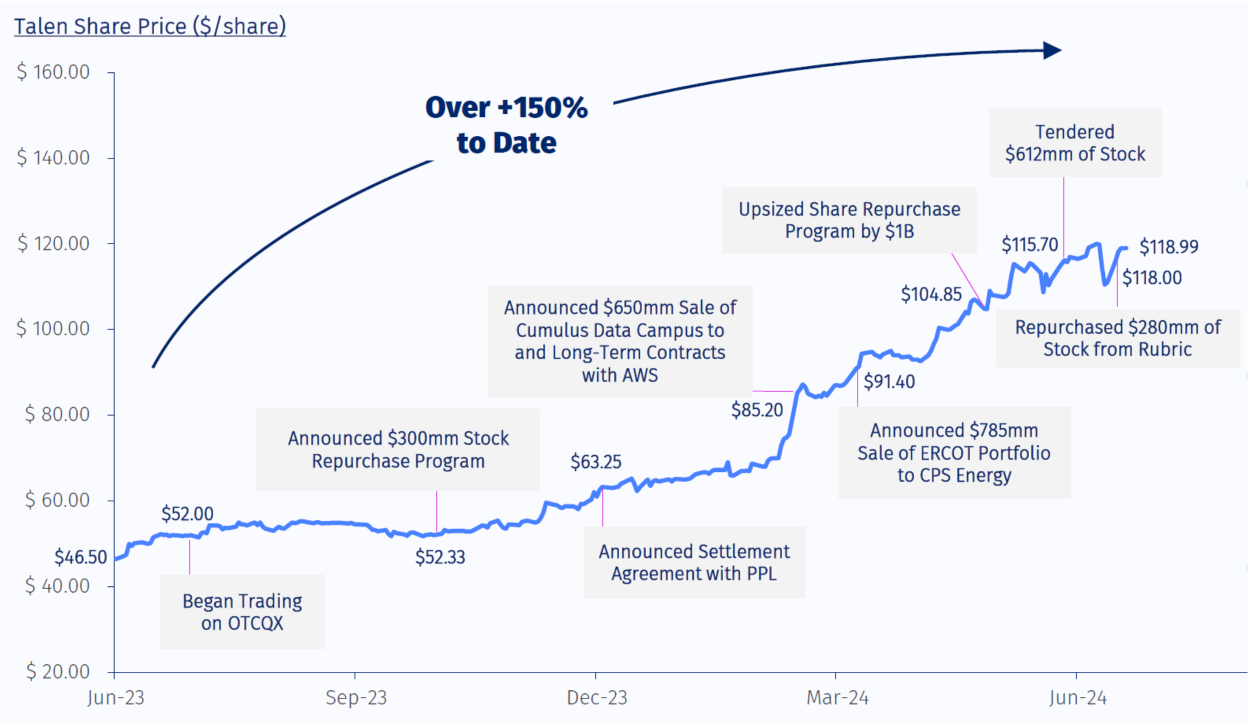
Second, we view the management team as high quality. Since we have invested, Talen has under-promised and over-delivered on every key aspect of the story. The company has reduced leverage, monetized virtually all of its non-core assets, repurchased a substantial portion of the stock, and successfully uplisted to the Nasdaq exchange. Operational results have also been excellent. It is rare to find an asset as well-run as Talen appears to be.

Third, we have identified a tangible growth catalyst playing out over the next 10 years. Talen agreed to sell a data center co-located with the nuclear plant to Amazon Web Services for $650 million in March 2024. Over the next 10 years, AWS has contracted to purchase as much as 1 gigawatt of power per year for a price nearly double the rate of the wholesale power price. This contract alone has the potential to generate an incremental $255 million in EBITDA for Talen per year by 2034 vs. Talen's current $700 million EBITDA run rate. Amazon is willing to pay a premium to source reliable carbon-free energy for a large data center and it will also benefit from certain tax credits associated with the project.

Finally, we see additional opportunities for per share value growth above and beyond the AWS deal. I am bullish on the supply/demand story for electricity playing out in the coming years. In addition, Talen believes there are additional opportunities to co-locate data centers next to its other power plants. Talen's capital allocation strategy of creatively monetizing existing assets while returning capital to shareholders should continue to work.

After gaining more confidence in Talen's execution and long-term growth potential, I added Talen to the Growth Portfolio at ~$99 per share in April.

The chart below was taken from the Company's July 2024 investor presentation and summarizes what Talen has been able to accomplish over the past year since emerging from bankruptcy. The stock has appreciated substantially; however, I believe there is significant upside remaining.



Until next time

Thank you for your continued support and trust in LVS Advisory.

Best regards,

Luis Sanchez

Luis V. Sanchez CFA

ABOUT LVS ADVISORY

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