VOSS CAPITAL

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May 25th, 2022

Dear Partners,

In Q1 2022, the Voss Value Fund, LP and the Voss Value Offshore Fund, Ltd., returned -5.5% and -5.5% to investors net of fees and expenses, respectively, compared to -7.5% total return for the Russell 2000, -2.4% price return for the Russell 2000 Value, and -4.6% total return for the S&P 500.

As of March 31st, 2022, the Fund's total gross exposure stood at 151.4% and the net long exposure was 73.3%. Our top 10 longs had a weight of 65.1%, and our top 10 shorts had a weight of -33.7%.

Long/short strategy[1] assets under management stood at approximately $306.6 million and Firm assets stood at approximately $344.1 million as of March 31st, 2022.

Voss Value Master Fund Complex

NET MONTHLY PERFORMANCE | 2022

PERIOD	Voss Value Fund, LP	Voss Value Offshore Fund, Ltd.	Russell 2000 TR	Russell 2000 Value Index	S&P 500 TR
JANUARY	-9.9%	-9.9%	-9.6%	-5.8%	-5.2%
FEBRUARY	4.4%	4.3%	1.1%	1.7%	-3.0%
MARCH	0.5%	0.5%	1.2%	2.0%	3.7%
1st QUARTER	**-5.5%**	**-5.5%**	**-7.5%**	**-2.4%**	**-4.6%**
APRIL					
MAY					
JUNE					
2nd QUARTER	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**
JULY					
AUGUST					
SEPTEMBER					
3rd QUARTER	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**
OCTOBER					
NOVEMBER					
DECEMBER					
4th QUARTER		**0.0%**	**0.0%**	**0.0%**	**0.0%**
YEAR TO DATE	**-5.5%**	**-5.5%**	**-7.5%**	**-2.4%**	**-4.6%**

The table below shows the Voss Value feeder fund returns compared to some of the relevant indices:

Net Return Comparison as of April 31st, 2022

					Compound Annual Growth Rate			
	1 Month	**3 Month**	**YTD**	**1-Year**	**3-Year**	**5-Year**	**10-Year**	**ITD(1)**
Voss Value Fund, LP	**0.5%**	**-5.5%**	**-5.5%**	**6.7%**	**20.6%**	**18.2%**	**17.7%**	**16.4%**
Voss Value Offshore Fund, Ltd.	**0.5%**	**-5.5%**	**-5.5%**	**5.9%**	**-**	**-**	**-**	**14.1%**
S&P 500	3.7%	-4.6%	-4.6%	15.6%	18.9%	16.0%	14.6%	16.4%
Russell 2000	1.2%	-7.5%	-7.5%	-5.8%	11.7%	9.7%	11.0%	13.3%
Russell 2000 Value	2.0%	-2.4%	-2.4%	2.1%	8.2%	6.0%	9.2%	11.4%
Russell 2000 Growth	0.5%	-12.6%	-12.6%	-14.2%	4.6%	7.1%	9.6%	11.9%
HFRX Equity Hedge Index	1.5%	-0.3%	-0.3%	8.9%	7.2%	4.9%	3.8%	3.9%

(1) Inception to Date measures the time period from Voss Value Fund, LP's inception date of October 1st, 2011, and from Voss Value Offshore Fund, Ltd's inception date of January 1st, 2020.

[1] Includes the Voss Value Master Fund and SMA

Loss hurts more than gain rewards, emotionally speaking.[i] At a 2:1 ratio, in fact, for most Americans. For Voss, losses are the equivalent of Medieval bloodletting. Like many painful rites of passage that are ubiquitous across many cultures and time periods[ii], The Great Humiliator must first (or eventually) inflict suffering upon you in order to bestow its wisdom and greatest lessons. There was far too much "easy money" made for too long and now many new investors have finally encountered their first excruciating rite of passage following the selloff this year. Time will tell if the majority cry uncle and bow out of markets entirely for many years or if, like me post-2008, the chaos seals their love for markets and they find a renewed religious-like devotion, but with a value-oriented framework.

It has been a difficult time to reconcile the macro and the micro. At the macro level, inflation is at a 40-year high[iii], the prospect of WW3 has been dangling over us like the Sword of Damocles, the Fed is raising short term interest rates "expeditiously," China is locking down some of the largest cities in the world, US government officials are doing their best to prolong supply chain disruptions and inflation (e.g., attack oil and gas companies, talk about price controls, etc.), and so understandably the angst and ongoing investor worries could be characterized by us as hysterical negativity. Indeed, retail investor sentiment has only been worse during a few weeks in all of history, including parts of 1990, parts of 2008, and March 2009. Ditto for consumer sentiment, having only been worse than it is currently in early 1980, June 2008, and March 2009.[iv] On the opposite side of the coin at the micro level, dozens if not hundreds of companies across a wide range of industries paint a picture of widespread economic strength and are providing extremely positive forward-looking commentary. Contrary to popular belief, S&P 500 2022 EPS estimate revisions are rising at a high single digit growth rate so far this year and they are rising across all 11 sectors.[v]

As is usual, the Voss view of the whole is more informed by a detailed bottom-up view of many of the parts. And because we are finding so many fast-growing companies with good operating visibility and low leverage at *very high* FCF yields, we have not become too bearish on the market as a whole. Of course, the same could have been said several months ago and it hasn't stopped most of these sorts of stocks from getting a lot cheaper as macro fears and the tech bubble burst contagion trounce bottom-up fundamental developments.

Statistically cheap and expensive stocks have de-rated in near equal proportion during this correction so far as of the date of this letter, leaving the cheapest decile of stocks the cheapest they have ever been relative to the market as a whole. We at Voss think as (if) the correction progresses, there will be an increasingly noticeable positive divergence between stocks at low absolute valuations that are aggressively returning capital to shareholders and the perpetually cash-burning bubble stocks that still lack any valuation support. As of the middle of May, using our Base Case price targets, which are calculated using a detailed analysis of the fundamentals of our portfolio companies, we estimate that the upside to our long book exceeds 100% in the next 12-18 months, which compares very favorably to our historical average estimate of closer to 30%. [vi]

New Core Long: Williams Sonoma (WSM)[vii]

We believe shorting furniture retailers has arguably become a consensus view on the back of widely known tough comps from early 2021 (+26% and +40% SSS Comps for WSM in calendar Q1/Q2 '21) and fear of pull forward of demand, which seems to be corroborated by weak credit card data in the category the last few weeks and a poor outlook from furniture e-Commerce giant Wayfair, not to mention a panic-inducing, rambling conference call from the oft colorful CEO of Restoration Hardware. Lazy thematic macro analysis that stops there, however, paints an incomplete picture of what has transpired at many individual companies like WSM that have been deemed Covid beneficiaries that are now at all-time low valuations.

WSM is a furniture and home décor retailer that owns several well-known brands: William Sonoma, Pottery Barn, Rejuvenation, Mark & Graham, and most importantly, west elm. While perhaps thought of as a dying mall-based brick & mortar retailer, WSM derives the vast majority (66%+) of its revenue from e-Commerce and has been a remarkably steady performer, remaining free cash flow positive every year since at least 2007 and achieving positive same store sales comps since 2010, including +17% in 2020, +22% in 2021 with guidance for a further mid-to-high single digit growth again this year. Within the overall positive sales trends, west elm's consistent growth has been even more impressive, with a 16% average annual same-store sales growth rate since 2012. To little fanfare, by our calculation,

WSM has become the single highest quality retailer in public markets with a 58% return on invested capital (ROIC) in 2021 and a 39% ROIC on average over the past 3 years.[viii]

With WSM the 5th most shorted retail stock and the consensus that furniture demand was pulled forward, it's important to point out that furniture spending as a percentage of total personal expenditures is still far below the long-term average and remains lower than any single quarter from 1990-2006, according to Bloomberg. The depressed furniture market post-GFC due to weak new home sales was the historical anomaly as opposed to the beginning of an upward reversion that kicked off in 2020. In 2020 the average annual expenditure on furniture per affluent household (top 20% by income) was still below 2015 levels.[ix] Furthermore, WSM's growth has outpaced the furniture market overall by an > 8% CAGR since 2012[x]. So even with a moderate industry slowdown, they are likely to continue taking market share at a fast clip as they did in 2020, growing 15% while the home furnishing industry overall declined 23%.[xi]

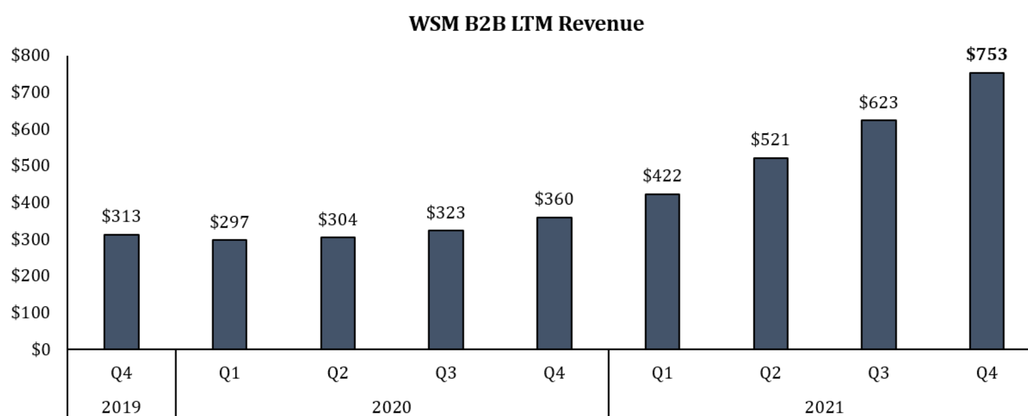
With the stock trading at an all-time low valuation currently, at 5.5x EV/EBIT (vs. 12x historical average), it is at a nearly 60% discount to a basket of slower growth, lower margin, lower e-commerce penetrated, lower ROIC retailers and is clearly pricing in some severe margin compression and revenue declines.

By our calculation, WSM's current stock price is pricing in no revenue growth despite guidance for mid to high single digit growth and for operating margins to get cut in half, from 17.6% to less than 9%. However, the Voss variant view is that there are several reasons to believe that majority of WSM's margin gains post covid lockdown will be more sustainable than the consensus thinks.

B2B

While we like the core WSM business and collection of brands by themselves, the company has an entirely new initiative that began in mid-2019 that almost no one is talking about despite its valuation potentially eclipsing the entire current enterprise value on its own within a couple of years.

In this relatively fledgling business-to-business (B2B) segment, WSM acts as full-service interior designer and furniture outfitter for large commercial clients and hospitality chains such as Marriott, Salesforce, Disney, and the Golden State Warriors. This business faces little competition from players who can operate at the same scale WSM does or who can provide the "one-stop-shop" experience of sourcing from a single vendor. Across WSM's 8 brands customers can select everything from couches to outdoor furniture to bedsheets to light fixtures. The business is currently growing at over 100% y/y doing $753 million in revenue last year at an estimated 25% - 30% operating margin. Even assuming a revenue growth slowdown to 40% per year, at 30% operating margins we think WSM's B2B business can generate over $600M of EBIT by 2024. Using a valuation multiple comparable to a basket of the top tier public retailers (as measured by margins and ROIC) we estimate just this one segment alone could be worth 100% of the current enterprise value, or $7.2 billion, within the next 2 – 3 years.[xii]



The beauty of the B2B business is that it's a natural extension of what WSM does best with its in-house design team and sourcing. It simply opens the door to a previously untapped $80 billion, highly-fragmented market opportunity, which WSM has quickly captured 1% of. The business fully launched in 2019 with management initially setting out the target of $1 billion in revenue by 2024. The growth has exceeded all expectations and we estimate B2B's Q4 2021 revenue run rate already easily exceeds $1 billion. As the CEO said on the Q4 earnings call, "*B2B just continues to go. I think I've revised my estimates every time I've gotten on this call. I decided not to give estimates anymore because I keep undershooting it. And that's embarrassing as well."*

Despite the rapid success, the B2B business is still relatively nascent in our view. For example, the company just began designing restaurant and hotel-specific furniture in mid-2021. Prior to this, the company was simply making contract-grade versions of its existing furniture line. Now the company leverages its industry-leading, sustainable manufacturing operations to cater to specific types of commercial customers with WSM, the CEO noting in May 2021, *"our win rates on large projects continue to improve."*

In addition to the triple-digit growth driving overall company comps, B2B sales also come at a higher gross and operating margin relative to the core business. While margins aren't specifically disclosed, the CEO says the margins are "incredibly accretive" since each B2B salesperson does "a ton of volume" working on large commercial accounts. There is also a high amount of repeat and replacement purchases which come at a low incremental cost to WSM. For example, of the $280 million in B2B sales in the first half of 2021, 70% of it came from repeat customers. The company has suggested that this is because once they land a commercial customer, they then have visibility to a pipeline of continued business:

"We're seeing the Marriott pipeline continue... we're seeing good internal indicators that the pipeline is only going to get stronger." – WSM President & CEO, *November 2020*

"We continue to see repeat business from some of our key customers like Salesforce, and we have a growing number of new projects currently underway." – WSM President & CEO, *May 2021*

"Our B2B sales are accelerating week after week as our project pipeline continues to expand" – WSM President & CEO, *May 2021*

The growth and margin profiles of B2B have required relatively little incremental minimal investment and will continue to bolster WSM's already industry-leading ROIC. While B2B sales are currently only around 10.5% of total WSM revenue, we estimate it already accounts for a mid-teens percent of operating income. By 2024, we think B2B can grow to become >30% of WSM's operating income and at 12x EBIT be worth $8 billion, easily above the entire company's current enterprise value of $7.5 billion.

Maintaining Margins

In addition to B2B, other new initiatives include International Franchising and Marketplace. These are also both higher margin than WSM's core retail furniture sales with faster growth and as they become a larger percentage of the sales mix, they should help to maintain WSM's mid-teens margins.

Marketplace is where WSM sells third-party vendors' merchandise without holding inventory or taking ownership of it. They simply use their website to list the vendors' products and take a fee. Global Franchise is a similarly high margin opportunity and is showing early success, particularly within India.

In addition to these new initiatives, over the last few years, WSM has been shutting less profitable stores (with the exception of unit growth in west elm) and has renegotiated leases on 90% of the remaining stores which has helped lower their occupancy cost (rent as a % of revenue) by over 500 bps.

While investors are currently in a state of what we believe could only be characterized as negative hysteria on durable purchases, if one looks beyond the lapping of tough 20-40% comps, we see the longer-term outlook as positive for WSM to continue profitably take market share in a growing industry. One of the best leading indicators

for demand for WSM's furniture is the sale of homes that cost >$750,000, which are running at +68% y/y on a LTM basis.[xiii] WSM's gem asset, west elm, does particularly well with Millennials and Gen-Z who are just now aging into their prime homebuying years and will need to furnish entire homes as millions migrate out of smaller multifamily units.

As of this letter, the stock is at an all-time-low valuation of 3.8x EV/EBITDA and 6.7x earnings with a clean balance sheet, zero debt, $850 million in cash, and a $1.5B buyback authorization (20% of shares outstanding at current prices). The company has consistently returned capital to shareholders and when they complete the current buyback, they will have repurchased 1/3 of the shares outstanding since 2015. We are happy to be buying more WSM at these levels. The stock has >100% upside in our base case price target, which would just put it in line with its 10-year average P/E and a 20% discount to its long-term average when ROIC and margins were much lower.

Conclusion

Inflation. Interest rates. Recession. This trifecta of worries dominates investors' collective psyche and ambiguity, uncertainty, and fear reign supreme. Nearly every talking head's commentary can be summed up as "just how bad can it get?" and "How much lower will we go from here?" Much can be said of this point of view, and we don't want to risk sounding Pollyannish; however, we would point out that the average small-cap stock is already down ~50% at the time of this writing with most of our portfolio at all time low valuations (including March 2009). We think the fear of recession in the near term is overblown and is creating attractive opportunities in cyclicals that appear to have already more than priced in a severe economic contraction. The rate of inflation could be peaking soon, too, as long-term inflation expectations already have reverted below even 2013 levels. Also, it is important to remember that plenty of historical market pullbacks have ended during growth slowdowns and without rate cuts, and conversely, plenty of bear markets have raged on despite aggressive cuts.

"…in Itself can make a heaven out of hell or a hell out heaven." The "it" John Milton is referring to here in Paradise Lost, of course, is the three pounds of ~86 billion neurons in between our ears. We have cultivated a high tolerance for uncertainty thanks to participation in markets since the early 2000s. Poise in the face of paradox and the ability to be at ease with ambiguity is an essential part of long-term investing success in public equities. Having conviction in our individual stock valuations also helps reduce our sensitivity to market drawdowns.

We can now choose to view the market's correction as an irrational, unfair punishment, or we can lengthen our outlook and view it as another painful rite of passage on our lifelong Alpha Odyssey and a terrific opportunity to reload our return pipeline with mispriced securities. We see this as a target-rich environment, and we are optimistic about our forward-looking returns.

Sincerely,

Voss Team

Appendix

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[i] Losses Loom Larger Than Gains in the Brain (https://www.anderson.ucla.edu/documents/areas/fac/policy/loss_aversion.pdf)
[ii] Sacred Pain: Hurting the Body for the Sake of the Soul by Ariel Glucklich
[iii] April CPI released 5/11/2022
[iv] University of Michigan, University of Michigan: Consumer Sentiment [UMCSENT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/UMCSENT, May 25, 2022.
[v] Bloomberg
[vi] Voss estimate, the individual base case is derived on an individual, company-by-company basis
[vii] Data included from sources:

- WSM Q1 and Q2 2021 Company Filings
- WSM Q1 and Q2 2021 Earnings Call Transcripts
- WSM Q3 2020 Earnings Call Transcript

[viii] Voss calculation, additional data available upon request
[ix] Source: Statista
[x] Euromonitor
[xi] Bloomberg Terminal
[xii] Voss estimate, additional data available upon request
[xiii] FRED: Federal Reserve Economic Data

Common Terms:

CAGR – Compound Annual Growth Rate	*GDP – Gross Domestic Product*
DCF – Discounted Cash Flow	*IRR – Internal Rate of Return*
EBITDA – Earnings Before Interest, Taxes, Depreciation & Amortization	*LTM – Last Twelve Months*
EPS – Earnings per Share	*NTM – Next Twelve Months*
EV – Enterprise Value	*P/E – Price to Earnings*
FCF – Free Cash Flow	*YTD – Year to Date*

Disclosures and Notices:

Beginning January 1, 2020, all investment activity is conducted by the Voss Value Master Fund, LP (the "Fund"), which has two feeder funds, and therefore performance figures from January 1, 2020 onward are calculated based on the Master Fund. All limited partners invest in the Fund through one or more of the following feeder funds: Voss Value Offshore Fund, Ltd. (the "Offshore Fund") and Voss Value Fund, LP (the "Predecessor Fund"), each a "Feeder Fund". Performance figures for the Predecessor Fund are contributable to Travis Cocke as sole portfolio manager. Mr. Cocke maintains the same the position with the Fund and the Fund will employ a similar strategy as the Predecessor Fund. Actual returns are specific to each investor investing through a Feeder Fund. Each Feeder Fund was established at different times and has varying subsets of investors who may have had different fee structures than those currently being offered. As a result of differing fee structures, differing tax impact on onshore and offshore investors, the timing of subscriptions and redemptions, and other factors, the actual performance experienced by an investor may differ materially from the performance reported above. Portfolio statistics shown are inclusive of the Predecessor Fund and the Offshore Fund. Prior to 2022, net results were presented at the Fund/feeder level, aggregating net returns of fee paying and non-fee-paying investors. Prior to Q1 2023, 2022, and 2023 net results were presented at the feeder level but were subsequently updated to match the method of presentation used for the Fund's 2022 Audited Financial Statements. Through Q1 2022, the net returns were previously reported as -5.48% and -5.53% for the Voss Value Fund, LP and the Voss Value Offshore Fund, Ltd., respectively, and were subsequently updated to -5.51% and -5.53%, respectively. A full chart is available upon request.

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