DECEMBER 31, 2022

INVESTMENT REPORT
4Q 2022

CT CAPITAL LLC

INTRODUCTION AND SUMMARY

In 2022 the accounts were down approximately 8%, well ahead of the S&P 500 and roughly in line with the Russell 1000 value. The account has outperformed both benchmarks since inception when compared to even a very low fee S&P 500 index fund.[1]

While values showed absolute decline in 2022, much of what we had written the past several years came true regarding the large S&P 500 stocks and unprofitable enterprises. All our holdings have strong balance sheets and consistent, and growing, normalized cash flows under low cost of capital.

Our firms have shown a historical and current ability to make wise use of operational cash flows toward value-adds, and during the quarter that good-sense prevailed despite the equity sell-off. Weaker credits only got weaker.

We know how to value going concerns, having in our past been retained, and resultingly, come to you with deep experience in M&A and fair value analysis on a global scale. Unfortunately, during December, stock valuations took on the common sense of investors who bought those non-fungible tokens a few years ago. Stocks were indiscriminately sold without regard to valuation, reversing, in small part, our performance relative to benchmarks of 2022's beginning eleven months.

And so, have no qualms saying your account is undervalued by a large measure.

Unless we as analysts are so far off in our estimates of fair value, there is no reason to believe the account will not see substantial returns over the (period(s) ahead.

Let us provide an example of recent investor liquidation without regard to reasoning.

Suppose Qualcomm, which, after our adjustments, reported $11.8B of free cash flows (yes, we made quite a few adjustments that ran the scope of the most recently filed September 25 10-K), and based on the cover page of 1.21B shares outstanding, or $10.50 per equity share.

Further, suppose for the coming two years the country enters such a terrible recession that Qualcomm does not show any free cash flow, a scenario so far-fetched we could hardly assign a probability, given the growth in EVs, IoT, new customers, technological lead, Apple agreement, etc. From that point, assume Qualcomm's ability to generate free cash flows returns to normal growth while cost of equity capital is unchanged at 6.9% and inflation runs at 2.26%, the current Fed breakeven point.

Such a scenario, without going into the fine details of the example, should only have impacted the firm's share price by a little over $10 a share, a far cry from the actual fall in the shares. If there is one, the catch is the firm's ability to produce its normalized real return on capital and economic profits, and the shareholder maintains the position throughout. We believe, once the current economic/financial period passes, its shares should hit new all-time high ground.

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[1] Two points on benchmark performance. (1) The S&P 500, by virtue of only 2 highly correlated stocks carrying a 12% combined weight, carries additional risk vis-a-vis our portfolio. (2) The cumulative return on an S&P 500 index fund, even at a low fee, generates a surprising shortfall relative to the annualized return

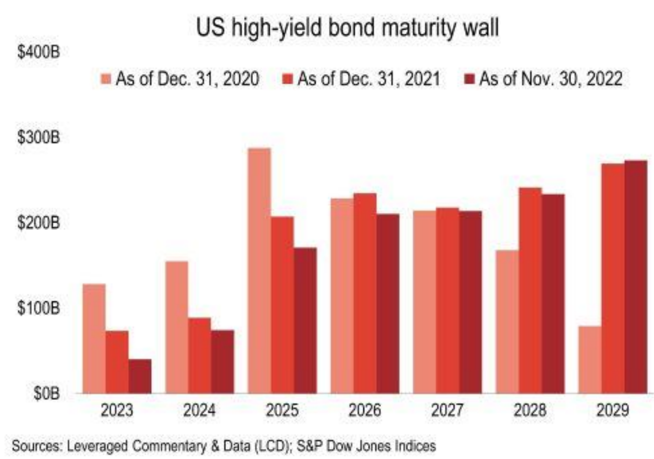
As we head into the new year, macro (sovereign, credit, etc.), tax factors, inflation, and repercussions from Fed tightening could perhaps restrain valuation multiples. The Fed may also see a sticky unemployment rate as employers fear an inability to rehire and train when their business turns upward. This will negatively impact margins in the short run. These negative factors will be bumping heads with the low valuation of our portfolio, placing us in a good position as events clear.

FIRMS WITH STRONG FINANCIAL STRUCTURES STRONGLY PREPRARED FOR AN ECONOMIC SLOWDOWN

Though firms having strong credit and stable metrics did not shelter investors in 4Q, including the only two AAA-rated firms, Microsoft and J&J, such is aberrational during periods of economic weakness.

With over half the S&P 500 firms facing an implicit increase in debt associated with large unfunded pension liabilities, CFOs must catch up with their years of underfunding, a cash flow issue going into 2023 due to recent financial returns. Many firms have continuously contributed lower than necessary cash to boost reported GAAP results. **We penalize firms that make low cash contributions in relation to unfunded liabilities and benefit payments in the same manner as we may increase total debt due to an increase in borrowings**. **Additionally, firms thinking they have free money by investing in private equity assets may soon well learn those smaller firms carried larger than perceive risks.**

Figure 1 High-Yield Issuers Have High Wall Starting in 2025



Middle-market firms should see an elevated jump in default rates in 2023, while our firms have the critical advantage of pushing out maturities or raising capital for value-adds. Middle-market borrowers are also typically more vulnerable to rising interest rates because their capital structures are predominantly composed of floating-rate debt and more limited use of hedging.

With the Fed bent on forcing a general recession, most of our holdings should still report real normalized growth in key metrics and stable growth in market shares (the $858B upcoming defense budget won't be doing Lockheed any harm). **A recession, should one develop, will force the Fed to halt its restrictive policies and shift to at least a neutral stance, benefitting equities from already depressed levels.**

Our holdings stand in a prime position both during the slowdown, where they can take advantage of their financial flexibility and as the economic deceleration ends. We expect our businesses to manage their balance sheets, capital spend, and implement cash savings and productivity measures without impairing growth prospects, as they have the financial structures to do so. Additionally, treasurers will shift cash and bring in additional areas of savings, such as captives in health and insurance, tax, hedge costs, and swaps, while division managers bring in further operational and supply chain savings, from robotics to labor and transportation.

Our financial adjustments take on increasing importance as the disparity between firms' "adjusted-GAAP" reporting tables with our adjusted free cash flow estimates grows ever wider. We have utmost confidence our analyses transcend that of most to all others. Upcoming FASB and SEC dictum add to such belief.

For example, as a firm expands its asset base via construction, the cost of an option to purchase land is capitalized, as are many pre-acquisition expenses, including labor. Other related expenditures may be expensed. ***Such reporting, whereby firms interpret FASB standards to their benefit, forms an essential element of our analysis****.*

Investors seem—at least in the short-run— to buy the "adjusted GAAP" nonsense. These tailor-made alterations are no more than an attempt to bump up executive bonus payments, though they may provide a few valuable details incorporated into our models. Upcoming SEC rules may put some of this allowable reporting nonsense to an end.

In our analytical dreamworld, firms would provide the same information we would require in a merger or fair value analysis. Such includes, in addition to all publicly available information, access to all financial record keeping, correspondence with any regulating agency which provides licenses or oversight, all notes, memoranda, summaries, analyses, compilations, forecasts, data, studies, interpretations, product plans, and inventions, including software.

NEW ACCORDS

Important new tax protocols impacting cash flows come to the forefront in 2023, including the non-deductible 1% excise tax on equity stock repurchases[2] and 15% excise tax AMT[3] based on book income, the rate consistent with the Pillar 2 accords[4]. **The AMT, if assessed, becomes a tax credit against future years' regular tax income**. This might cause corporate manipulation as the AMT, and other aspects of the code provide fodder for gamesmanship.

Concerning the upcoming 1% excise tax, the actual tax occurs once a year though reporting is done quarterly, perhaps requiring an adjustment to cash flows.

US tax laws require capitalization and amortization of R&D expenses starting in Q1, raising tax rates for many firms.

That the SEC will vote to provide additional segment reporting is a step in the right direction and represents a compromise between regulators and issuers.

A current FASB proposal would require a detailed tax breakdown by jurisdiction, including an explanation of effective and cash rates, which would be beneficial in our analysis.

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[2] There are exceptions and deductions available such as shares issuances, M&A, and stock contributed to a benefit account, among others.
The SEC issued interim guidance at quarter's end which may be found at https://www.irs.gov/pub/irs-drop/n-23-02.pdf

[3] At quarter's end the SEC released initial guidance, found as Notice2023-7

[4] See https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf for additional information

New clawback rules relating to financial restatements require firms to recover faulty executive bonus payments.

There are new requirements on pay versus performance reporting, executive compensation, ESG reporting[5], and the virtual end of LIBOR.

Be confident we are fully prepared for all upcoming "pushes and pulls."

COMMENT ON THE 2022 FINAL QUARTER

SPOTLIGHT ON INSURERS

The quarter was highlighted by several stocks reaching all-time highs; others languished though financial results were acceptable. Those stocks hitting all-time high valuations during 4Q were too lagging a short while ago.

Currently, inflation is working through inventories, impairing cash from operating activities, especially for the many companies guilty of over-ordering on fear of supply chain interruptions. **As firms draw down inventory levels as products are shipped, the added costs will be passed on to customers, boosting cash flows, reducing the bloated inventory, but hitting GAAP profits. The impact on equities should be positive and requires adjustments to current and forthcoming balance sheets for normalization**.

Our insurers, which experienced a rise in unrealized bond losses as interest rates climbed early in 4Q, have nevertheless had good premium growth while effectively managing costs. Importantly, CFO's improved credit, recasting fixed debt to lower coupons with extended maturities. During the 2007-2009 credit crisis, those firms which did not control costs were exposed.

Many insurance specialties, like D&O, cyber (Figure 2), and reinsurance, remain tight, and our PC firms should see good-sized premium increases in the years ahead, partly due to high claims in 2022. However, any further rise in natural disasters could offset any rate increase.

Figure 2 Expected Growth in Cyber Crime

[5] The DOL is overturning a Trump administration rule, allowing ESG factors to determine investments for retirement and other fiduciary plans.

We are mindful of our insurers with auto exposure (i.e., Travelers) as EV production grows. EVs are considerably higher to repair due to their complex technology and high battery replacement cost.[6]

Several investee firms, including technology holdings like Qualcomm, have not commented on additional tax, which might be called for under the 15% alternative tax. Any extra tax is expected to be minimal for others that have, like our holding Lockheed.

Most LIBOR rates have been discontinued post-December 31,2021, while the remaining LIBOR provisions will be terminated immediately after June 30, 2023. The change should not significantly alter our estimate of fair values.

The value of the US dollar may have credit implications, depending on the firm's operating structure, the effectiveness of hedges, and financial flexibility. Our firms, having sound financial structures, stable normalized and adjusted free cash flows, and the ability to produce a value-adding return on capital, should have little difficulty with currency volatility, given swaps and other hedges. On the other hand, many highly leveraged entities are sure to teach investors the actual cost of debt was not the initial coupon rate, as the debt is eventually recast at higher coupons and spreads.

INTERIM REPORTING

With Q3 in the books, we await 10-K's, including revelations not required under interim reporting requirements.

This is not to suggest interim reporting is unimportant in firm evaluation.[7] For instance, **seasonal firms often require a significant use of cash, keeping investors on tenterhooks hopeful purchasing managers correctly anticipated demand and supply flows**. For seasonal firms, interim reporting showcases how the assets are managed, forecasting ability, and executive effectiveness in providing shareholder value.

Under certain circumstances, firms are permitted to report cash from operating activities as a single line entry, requiring our estimating its components from the other two main statements, footnotes, and historical filings.

In the case of American Airlines, a firm we do not own, a one-line entry for cash from operating activities is reported. We would consider aside from their enormous government assistance, working capital, tax, benefits (pension), and other activities that require adjustments to grasp valuation.

Where any primary balance sheet caption is less than 10% of total assets, and the amount in the caption has not increased or decreased by more than 25% since the end of the preceding fiscal year, the caption may be combined with others, requiring financial digging and perhaps adjustments, but giving us a "heads-up" on expectations.

COST OF EQUITY WHEN THE 10-YEAR TREASURIY YIELD IS "ARTIFICIAL"

[6] A new entrant, VinFast, a Vietnamese firm, will replace the battery for the life of the vehicle, an attempt to gain a foothold in the US market. It is our informed judgement as increasing production comes on stream, firms will trade market share for margins

[7] For additional information on upcoming segment reporting requirements, see https://fasb.org/Page/ShowPdf?path=Prop+ASU%E2%80%94Segment+Reporting+%28Topic+280%29%E2%80%94Improvements+to+Reportable+Segment+Disclosures.pdf&title=Proposed+Accounting+Standards+Update%E2%80%94Segment+Reporting+%28Topic+280%29%3A+Improvements+to+Reportable+Segment+Disclosures&acceptedDisclaimer=true&Submit=

Over the past year, we have shown charts comparing the expected inflation rate to the nominal rate on the 10-year treasury yield, the latter a beginning point from which our cost of equity is estimated.

But what if, as we saw, the 10-year Treasury yield is brought downward by massive Fed cash injections into the financial system? —the short-term implication being negative real rates with an implied jump in future inflation.

Rather than use the "artificial" 10-year rate during those rare times, we opt for our models to employ the 10-year Fed breakeven, the expected annual inflation rate over the decade. From that point, we add our laundry list of qualitative and quantitative factors.

ESG – A SERIES MATTER[8]

Fines for pollutants have often placed firms in precarious credit positioning, perhaps denying them value-enhancing opportunities which could have bolstered shareholder value. Some large equity holders instruct their advisors to refrain from investing in such firms.

A new entry to cost of capital analysis is the upcoming requirement on ESG, with the EU requiring far more detail than the US. The sustainability requirements are not to be underestimated as they will be on equal footing with financial reporting, hoping to force a change in firm operations. Firms, from industrial manufacturers to banks and insurance firms will be impacted.

To the extent investors believe sufficient ESG information is lacking, the level of uncertainty boosts the cost of equity, hence lowering the valuation multiple.

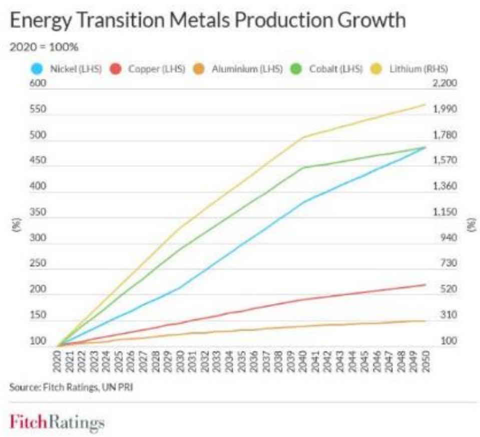
Our investment decisions are based on economic and financial activities, not ESG factors, unless the latter impacts financial results, expectations, or changes to cost of capital. In the meantime, we await the final word from the SEC on ESG reporting requirements.

Freeport-McMoRan

Demand for copper should see unabated normalized growth due to the EV transition and eventually an end to the worldwide economic slowdown. A continued economic slowdown will only serve to postpone this inevitability.

Panama announced it was shutting down a huge copper mine this month until a new royalty agreement was signed, **illustrative of the sovereign risks of commodities required for EV production.** As demand continues the expected path, we believe our investment in FCX should see robust adjusted free cash flows, cash-based return on capital, and a boost to its market value.

[8] The push for ESG reporting is far from universal. Florida Governor DeSantis said the state’s pension funds will no longer consider ESG criteria when seeking to generate the highest returns possible



CONCLUSION

A good security analyst should never complain about temporary performance—only about poor execution of the executive teams of firms in the portfolio. Over time, if the analysis is complete and accurate, valuation will take care of itself.

We look forward to strong performance in the years ahead.

Best wishes to a healthy 2023 and beyond.

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