

RF Capital Management LLC

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Dear Investors,

In the first quarter of 2022, RF Capital returned +3.06% net of all fees. Additionally, RF Capital generated a +54.3% and -0.56% return net of all fees in FY 2021 and H2 2021, respectively. Please check your individual statements for your exact returns.

Although we aren't benchmarked to a specific market index, we are quite satisfied with our positive return in Q1 2022. In comparison, market indices like the Russell 2000, S&P 500 and the Hang Seng Index declined by 7.53%, 4.95% and 4.98%, respectively. Sustained outperformance of 8%-10% or more versus market indices is quite significant. While we won't outperform the markets like this every quarter, it's important to have quarters like this on occasion in order to generate strong returns over the long term. More importantly, generating an absolute return regardless of the market environment is mission critical to our success.

We also ended the quarter with a 26.21% cash position – though accounts range from fully invested to higher cash positions (i.e. 52.84%) depending on the timing of inflows. Newer investors tend to have more cash. However, we expect all accounts to mirror each other over time in terms of position sizing.

In this letter, we will briefly review Zengame Technology and Sprouts Farmers Market. Next, we will provide an operational update and our full-year 2022 outlook.

ZENGAME TECHNOLOGY (2660.HK)

Zengame generated strong YoY numbers in FY2021. Revenue, gross profit, profit, and EPS increased 98.5%, 148.3%, 126.4% and 122.7%, respectively. The gross profit margin was 61.4% compared to 49.1% in the previous year, and the net profit margin was 33.9% versus 29.8%. Also, the dividend increased 150% YoY. KPIs trended upwards as well. Cumulative registered players, MPU (virtual items) and ARPPU increased 19.32%, 46.53% and 251.43% YoY, respectively.

Board games performed particularly well. Revenues from board games increased 13.3x from RMB64.4M to RMB918.0M. Sales of virtual items also increased 306.9% from RMB256.3M to RMB1.0B. Additionally, Fingertip Sichuan Mahjong ranked in the top 2 on iOS bestselling board games in China and ranked first for live streaming card and board games on Douyin.

In 2021, Zengame launched seven new games (3 card and board games and 4 casual games). Also, the company enhanced promotional efforts on Douyin, Tencent Video, Kuaishou, Xigua and Toutiao. While costs increased, the marketing efforts seem to have paid off with strong YoY growth numbers across the board.

Currently, Zengame is our largest position at 22.62%. Our average cost basis was HK\$1.15/share. We continue to hold shares in Zengame due to the company's continued growth and favorable PRC mobile game industry trends.

SPROUTS FARMERS MARKET (SFM)

Sprouts continues to make progress despite inflation and supply chain constraints. For the year, SFM opened 12 new stores and 2 new distribution centers. Also, SFM launched over 5,700 new products and 4 new format stores. More importantly, Q4 traffic was positive.

On the other hand, sales, EPS and FCF were down compared to FY 2020. However, using 2019 figures may be more useful given how COVID-19 provided a huge tailwind for SFM. If we consider 2019 sales, EPS and FCF as normalized numbers, then Sprouts is still performing well given how net sales, adjusted EPS and cash flow increased 8%, 68% and 3%, respectively, versus 2019.

Guidance for 2022 was also positive. Management has provided the following:

- Sales growth of 4%-6%
- Comp store sales growth of 0%-2%
- 15 to 20 new stores
- Flat gross margin and SG&A increase of 4%-6%
- Adjusted EBITDA of \$330-\$345M
- 25% effective tax rate
- Adjusted EPS of \$2.14-\$2.24
- CapEx of \$150-\$170M

Additionally, SFM is on track to achieve its 10% store growth target. The real estate team currently has 80 approved sites and more than 50 signed leases. By 2023, SFM should be closer to the 10% growth target.

Overall, we believe Sprouts remains a great long-term investment. SFM continues to be one of our largest positions at 14.10%. Despite COVID-19 no longer providing a tailwind, sales, EPS and FCF continue to grow and new stores are opened every year.

OPERATIONAL UPDATE

Due to new inflows of capital, we are increasing RF Capital's minimum investment size and management/performance fees – effective immediately.

The minimum investment size is now \$500,000. Additionally, the management fee and performance fee have been increased to 1.5% and 20%, respectively.

For existing investors, nothing changes. Your fees will remain the same and your account size does not have to meet the new minimum. However, it would be much appreciated if you could bring your account value up to RF Capital's minimum over time if possible.

If you have friends or family who may be interested in investing, we will be offering all referrals the same original terms (albeit with a higher minimum): \$250,000 minimum investment, 1% management fee and 15% performance fee.

The grace period will last until September 30th, 2022. After the third quarter, we will not be waiving our minimum and fees for new investors.

Additionally, we hired a Summer Investment Analyst Intern in February. We look forward to having him join us in May and will provide more details in our next letter.

We continue to offer summer internships to talented undergraduate students early on in their academic career. Part of it is we enjoy mentoring and developing the next generation of investment talent. However, the primary reason we do it is to develop our internal pipeline of talented analysts. When RF Capital reaches a certain AUM, we inevitably will have to add full-time investment analysts. Additionally, talented young professionals tend to end up at bulge-bracket investment banks or \$1B+ hedge funds. Thus, we want to identify talent early and offer them an alternative career option. At a smaller shop, they will have more autonomy, better investment training/mentorship and more hands-on experience with the portfolio.

OUTLOOK

Despite the difficult market environment, we are excited about our current opportunity set. Over the next quarter or two, we are likely turning over 50% to 75% of the portfolio. While we see more upside in our current holdings, many companies in Book 2 (our secondary portfolio) are even more attractive on a risk-reward basis. We are currently in the process of selecting 4 to 7 companies out of around 30. The projected high turnover is due to opportunity cost – not because we no longer have conviction in our current portfolio holdings. In fact, we will continue to monitor our current names and may repurchase shares again at a later date.

However, we are seeking more upside at this point, and we are also looking to decrease the average market cap of our portfolio holdings. Our portfolio is still considered small cap given that the median portfolio market cap is ~\$1.5B. Nevertheless, our current objective is to lower the average market cap to sub-\$500M.

Thank you for your support, continued interest, and referrals. Please email me at roger.fan@rfcapitalmanagement.com if you have any questions, concerns, or comments.

Best regards,

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RF Capital is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy, investment process, stock selection methodology and investor temperament. Our views and opinions include “forward-looking statements” which may or may not be accurate over the long term. You should not place undue reliance on forward-looking statements, which are current as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate.

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