

2018 First Quarter Commentary

Product Overview

As a refresher, the White Brook's Concentrated Opportunities Strategy ("Strategy", "Portfolio") is considerably unbounded – able to invest in any concentration in any security or sector. It should be expected to typically hold between 5-15 securities and be overweight a few industries. It is an environmentally and socially responsible mid-capitalization portfolio, and a large majority of the investments attempt to take advantage of a dominant theme rather than *only* be focused on valuation. Investing ahead of the adoption of big data through the economy has worked well so far, and the larger so-called "SaaSification of the US Economy" is likely to continue to dominate the portfolio in the medium term.

By concentrating investment, the Portfolio should be relatively uncorrelated to market indices. It has, and is likely to continue to have, periods of outperformance and underperformance relative to most market index tracking securities. Since inception, through the end of the first quarter, it performed favorably compared to the appropriate mid-cap indices, the S&P400 and Russell Mid-Capitalization indices, and in-line with the S&P500. Clients interested in performance over any time horizon should sign into their investment portal, while other parties interested in more granular performance should reach out to IR@whitebrookcapital.com.

White Brook subscribes to a "buy and hold" investment philosophy. While White Brook will enter and exit stocks in the Portfolio, the bias is to find very good companies trading at a cheap price and to stick with them as they outperform the market over a long period of time. The approach should result in relatively low portfolio turnover and therefore tax efficient gains. Those qualities are an output rather than in input, however. White Brook doesn't seek to buy, sell, or hold stocks for the sake of it, instead, stocks are bought and sold to gain exposure to new investment opportunities and to create the opportunity to gain exposure to new investment opportunities whose long-term risk-reward is more favorable than existing investments.

The Portfolio is managed to avoid permanent impairment of capital, but White Brook's philosophy is to welcome daily, weekly, monthly, and quarterly volatility. White Brook would be more than happy to provide you with a non-exhaustive but impressive list of risks and welcomes all calls and questions.

In its 10 full months of existence, the product has worked as designed. Its monthly beta (a measure of returns due to market movements) is relatively low compared to the S&P 500 and mid-cap indices while overall performance has been inline to favorable implying alpha generation. While data points are still few, this suggests that the market's performance will not be a good predictor of the Portfolio's over time. I believe this is desirable makes the product attractive to a wide range of investors.

Portfolio Review

Within the quarter, the Portfolio performed solidly in January, well in February, and poorly in March. It underperformed for the quarter.

Overall, the portfolio “*random walked*” in the quarter, with most positions up or down by small amounts, sometimes having been up or down by large amounts intra-quarter, but not as a result of meaningful price setting. Of the stocks that were price set, Keysight (KEYS), a stock that I highlighted in the 3rd quarter 2017 commentary was up ~25%, another, Envision (EVHC) was up over 10%. Our largest decliners included Box (BOX) and WageWorks (WAGE).

WageWorks (WAGE)

As White Brook grows, a culture of self-criticism, introspection, and a strive for perfection will be key traits in those that work here. WageWorks (WAGE) is particularly unfulfilling in that regard.

WageWorks is a \$1bn+ administrator of health and transportation savings accounts for employers that was rolling up the industry, leveraging a superior technology platform. The quarter was marked by the Company receiving approval to operate as a non-bank custodian - an event that confirmed the bull case thesis that White Brook subscribed to and that would have positioned the company to grow earnings rapidly and take market share.

My concern with the company grew in the second half of February as the Company failed to announce its earnings call and it crystalized on March 1st when the company communicated it would be unable to file on time. The way it was communicated, a haphazard press release during the trading day, and then a more normal notice after the market close, led me to believe that the inability to file was due to something more significant than increased filing requirements associated with becoming a non-bank custodian. I sold our shares.

In early April, WageWorks announced that it had fired its chief financial officer and its general counsel. It also announced it would need to restate earnings for the previous periods. While WageWorks may have assets that continue to be enviable, for WageWorks to become a dominant player in its industry, it needs to be able to both execute on its business and acquire other companies. With the underlying fundamentals on questionable footing due to the alleged fraud, the company is likely to be unable to obtain reasonable funding to finance its acquisition efforts for the foreseeable future.

In March, I recognized the thesis was broken, the events in April confirmed that decision. As I reexamine the fact pattern and how it was traded, it’s hard to recommend a different course of behavior. In a no-fraud world, the intrinsic value was significantly higher than the stock price in my view. Fraud is hard to learn from – as a passive minority investor, it’s difficult to perform the checks necessary to allay that risk and therefore the investment in WageWorks was an unfulfilling mistake to make.

Box (BOX): I added to the position in Box during the quarter and believe that the drawdown will be short lived. Box traded down after revealing earnings that beat estimates (including better margins and cash flow than expected), but disappointing guidance for the next year.

A critical reason for the disappointing guidance was a slowdown in marketing aggression to standardize and implement best practices across the rapidly growing salesforce. It's the appropriate move. In July of last year, recognizing the need to improve Box's salesforce, the Company hired Stephanie Carullo (previously of IBM, Apple, Telstra, and Cisco) to be Chief Operating Officer, specifically due to her go-to-market expertise. With free cash flow and free cash flow margin significantly higher than sell side and White Brook's expectations, and White Brook's belief that salesforce productivity is the key to long-run stock performance, to White Brook, the plans revealed on the quarterly call were value enhancing. Market participants were more focused on below expectation revenue guidance, however. Box has traded down between 5 and 10% after every earnings release since White Brook has owned the stock, but the stock traded down more than 20% in the immediate aftermath. While the stock recovered a majority of the loss by mid-March, in the last week, the Street seemed to move capital from Box to its newly public competitor, Dropbox (DBX). In April, Box has begun to claw back some of that relative performance.

In my view Box is a vastly superior Company to Dropbox and its other competitors, despite its smaller size - and it's trading for a very cheap multiple of recurring revenue on an absolute basis. I believe shareholders will be rewarded over time. (Edit: On 4/23, a venture capitalist, Social Capital's Chalmaith Palihapitiya recommended Box as his top pick at the Ira Sohn investment conference - the stock is up ~10% and beginning to approach its pre-earnings trading range).

Market Discussion

There are broadly five investment alternatives one can hold at any time: cash, cash-like alternatives, debt, equity, and real estate.

Cash can always be expected to depreciate on a real basis at the rate of inflation less money market yields. I believe inflation is likely in the short-medium term as the economy continues to grow. Cash represents an option to invest later but is a relatively poorer option than it has been.

White Brook does not have an opinion on cash like securities at this time. They have been beneficiaries of global trade uncertainty and increasing inflation expectations, but White Brook advocates clients wishing to avoid equity volatility consider short term fixed income investments that take advantage of increasing short term interest rates, without enduring inflation risk, rather than a pure inflation hedge like gold or silver.

After a significant move in the US 10-year Treasury, long term bonds are more attractive than they have been.

Equities continue to be well-valued but not severely. While the economy grows in excess of 2.5%, the market's valuation is within the realm of reasonable given interest rate levels. Previously, there was significant slack between interest rate levels and the stock market's

valuation such that interest rates could increase significantly without having an impact on the stock market - in the absence of a real economy impact. While some still exists, with the 10-year treasury at ~3%, a significant amount of that slack has been used. White Brook believes that the 10 year at ~3% is likely to be stimulative to the economy, giving savers, particularly elderly savers a return on their investment and therefore greater purchasing ability. The impact on the stock market will not be totally benign as fixed income becomes a more worthwhile investment, but the real world impacts of higher interest rates are likely to favor specific stocks and sectors, in my view.

I recently posed a question to a few other experienced investors whose opinions I respect, “Has the stock market, as a whole, ever been up or down in the ballpark of what you thought?” The answer was no. With over a century of cumulative investing experience, the only consensus was that most meaningful market moves come from generally unforeseen circumstances.

Whether the market is up or down, White Brook’s position is that equity valuations are highly dependent on future growth. Potential changes to the overall economy’s rates of growth, inflation, and interest can be expected to have an impact on the valuation of the market, with foreign exchange rates and a mentally declining President serving as a catalyst altering the trajectory of any one or all three. Rather than attempting to “time the market” efforts are better served at finding good companies that can be held for the long-term while being hyper vigilant about rising risks. That’s White Brook’s philosophy.

In Focus: Stitch Fix (SFIX)

White Brook started a new position in Stitch Fix during the quarter. In a bid to make these letters more readable, I’ve decided to split out the *In Focus* section when it relates to new positions. If interested in White Brook’s Stitch Fix thesis, please navigate to <https://ptdrv.linkedin.com/vzqvdx4>.

As always, feel free to reach out to discuss this or any of your investments at White Brook Capital. I thank you for your support and will strive to continue to earn your trust.

Regards,



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