

2019 Second Quarter Commentary

Portfolio Review

During the second quarter, White Brook Capital was up 5.46% vs the S&P Midcap 400 up 3.05% and the S&P 500 up 4.30%. Overall, second quarter earnings were supportive for White Brook. Portfolio earnings were strong during the quarter, despite the negative performance of Box, Inc (BOX), our largest position, that disappointed and traded down in the quarter. I remarked last quarter that expectations had been lowered and outperformance was more likely, and that was generally true in the second quarter.

White Brook again didn't trade during the quarter - except for investing new investor capital. White Brook has a multi-year investment horizon and targets high after-tax returns which means trading occurs when there are large opportunities or risk management needs, not because of boredom. I continue to be happy with the composition of the portfolio but do see new opportunities with compelling medium-term risk reward that may result in new positions soon entering the invested portfolio.

Market Overview

As I've told many of you, in my nearly 15 years in the public markets, I have yet to see a light turn green on CNBC or Bloomberg signifying it's all clear mindlessly invest in the markets broadly. That light only turns on faintly, when the stock market seems to be broken, the present seems hopeless, and stocks generally seem to be just pieces of paper disjointed from the ownership share that they represent. God bless the market timers persistently looking in the tea leaves and calling for 10% moves. For those of us that do bottoms up work, there are always opportunities – when others feel bad, when they feel good, when the market is up, and when it's down. We evaluate them on a stock by stock basis and hope to allocate capital in superior risk/reward situations that will benefit our investors. On that basis, as usual, there are an average amount of select opportunities and we'll look to stay invested.

Outperformers

The new stocks entered during the fourth quarter of 2018, First Solar, Inc (FSLR) and Itron, Inc (ITRI), were the portfolio's top performers. Both continue to be well positioned.

Itron was a noted underperformer last quarter. As a refresher, last quarter I noted that the company underperformed primarily due to the continued shortage of MEMS chips that delayed and increased Itron's cost to provide older model smart meters no longer in stocked inventory. I also noted that the largest shareholder at the time, Scopia Capital, had created technical pressure by committing to reducing its stake by selling its shares on the open market. I viewed both as short-term issues.

During the second quarter, the company reported a slightly better than expected quarter and Scopia's sales as a percentage of shares traded were significantly reduced during the second half of the quarter.

The stock recovered. I expect continued appreciation in the stock price as the shortage of MEMS chips abates, with indications that it could occur more quickly than previously expected. Over the long term, the increased complexity of utilities' grids - driven by the continued spread of solar generation, the increased electrification of transportation, and the need for more monitoring equipment and analysis software to make cities more intelligent and efficient - will continue to generate demand for Itron's smart meter, analysis, and control systems for years to come. There are likely to be slow quarters, but the future is bright and the valuation is still undemanding.

First Solar is a provider of solar modules to the industrial and commercial segment. Despite lackluster earnings reported during the second quarter, the stock appreciated due to the growth in the backlog as their offering continues to be attractive to industrial customers globally.

Solar is having its second moment, and I believe that First Solar is the best positioned to take advantage. First Solar is an industrial and commercial solar module producer. While often thought of as a homogenous solution, solar generation assets should be considered on a spectrum with retail and industrial applications on opposite ends.



Industrial solar installations are built for utilities, usually with production capacity confirmed before installation, or less frequently on spec, with multiple potential proximate commercial customers.

Commercial installations are also large, but significantly smaller than industrial installations, and are built to offset a company's carbon footprint or to provide electricity for manufacturing or data center operations at a specific site.

Retail commercial is becoming more commonplace, with retailers like Walmart commissioning builds at their stores or distribution centers. Community solar projects also fit within this category, where a group of residential customers will agree to use a specific solar project for their electricity alleviating the negative impact of rooftop solar.

Finally, residential which is often installed on homes.

The physics of generating electricity using solar technology are the same across the spectrum. A solar module produces electricity at the rate that the solar panel is exposed to sunlight, limited by the efficiency of the panel and the inverter used to make the electric current generated, usable. Sun exposure to the

panel is different from sun exposure **through** the panel. A well-tuned solar module needs foliage cleared (obvious) and dust washed away (less-obvious) to achieve its potential. Once the electricity is in the panel, the electricity needs to make its way to the grid. Solar module makers use solar inverters that condition the electricity for use at the individual panel, the multi-panel, or the node level - all which impact the efficiency of the entire installation, its cost, and its resiliency to failure. Efficiency, therefore, shouldn't just be considered on as a point in time, but over time, accounting for the lifespan of the installation, and the probability and cost of part failure.

Residential customers have a proclivity to install the most theoretically efficient panels and inverters possible, but due to the limited space on a roof and the need to get costs down, to have a very limited number of inverters. This means that while they're potentially incredibly capable, they're not very resilient. Additionally, a residential customer's tolerance to pay the necessary operating costs to maintain and clean the panels is low. In real life, consumers treat their panels like consumer electronics, their value is higher than the cash flows generated at the initial installation, and the perceived value declines below cash flow relatively quickly as the technology ages. Finally, the average house is owned for 7 years, while an installation is capable for 20 years. If the new buyer does not agree on the aesthetics of the installation, solar devalues the home. Residential solar, in my view, is not a great area for investment for the consumer or for an investor.

The shortfalls present in the residential market, decline the "more industrial" the installation. In that segment, the costs to install and upkeep the modules near peak efficiency are critical to achieve the priority of the investment – a solid IRR. First Solar's modules are exceptionally cheap to install and maintain – producing consistent predictable current even if the peak efficiency is slightly lower than peers. Given the advantages of large solar installations vs distributed residential, I believe that generation is likely to increasingly tilt towards those use cases. First Solar is extremely well positioned, and I look forward to continued gains.

Underperformers

The largest drivers of underperformance were Box, Inc and Mosaic, Inc (MOS).

Mosaic reported a good quarter and has resolved its issues with its 2 Brazilian dams at or ahead of schedule. The floods in the Midwest that I flagged would be an issue over the short term as they pushed out or cancelled fertilizer orders continue to weigh on the stock.

The Company trades at a similar level to where it traded 3 years ago, when it was more highly leveraged, commodity prices were lower, cash flow generation was more sporadic with future capital intensity more significant. The Company did not have regional diversity of production, and the global supply demand environment was worse. I believe the stock continues to be cheap as investors over-compensate for

weather concerns combined with general disdain for non-SaaS stocks and a desire to be in stocks that “are already working”. In time, I believe Mosaic will be a very good investment story where our patience is paid off.

Box, White Brook’s largest position, reported an in-line quarter and disappointing guidance for the year, reducing expectations for a second time in two quarters. When they reported last quarter, I had hoped that they had fully considered possible headwinds rather than having to lower guidance again this quarter.

There were three revenue items of note:

1. **They have a large customer that is churning off.** I believe it to be GE, which has very significant and well publicized cash flow problems. True retention revenue growth would have been closer to a much more acceptable 10% than 8% without the customer churning off.
2. **Deals are getting bigger and the closings are taking longer.** If deals were only taking longer to close and were the same size, I’d be concerned. If deals were getting smaller and were closing in the same amount of time, I’d be very concerned. But management indicated that deals are getting larger and more involved.
3. **The EMEA region which hasn't been productive, closed several deals.** This is one of the first signs of progress in the region in a long time even while the total contribution was small.

My investment case in Box modelled for deals to be increasing in size and closing in the same amount of time as smaller deals. The extension is a cause for some concern, but if successful, Box’s stock price should benefit tremendously. White Brook looks for companies that are either the best, easiest, cheapest, or necessary for its customers, with the obtainment of one and development of another key to our investment case. Box has been the best for some time, particularly within large companies and regulated industries, and it’s platform is now able to facilitate company processes that are fundamental to an organization’s next 5 years of development. It’s becoming necessary for companies that want to understand how much can be done with their data, break the silos that previously prevented that information from being used, and optimize processes to collect, analyze, and use data throughout their organizations to use Box. Simple sharing and collaboration, has been commoditized, but for organizations that want to do that plus use artificial intelligence and workflow processes to enhance productivity across business functions, Box’s function lead is growing. In the near term, the hope is that the largest deals that have been delayed will close in the coming quarters as Companies’ more extended due diligence processes end and decisions are made.



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As I look forward, the company doesn't have regulatory risk present in other large cap tech companies and is likely to be a beneficiary if regulation comes for the industry. Additionally, its scalable capabilities mean it's a high-quality asset for others who need to get bigger, or need a more significant enterprise focused, feature rich offering. Dropbox comes to mind, as does Atlassian, Apple, and Salesforce. It's platform neutral, best of breed, open-AI market position continues to be a good one. With two expectation misses in a row, the company has little credibility in the stock market and the stock price reflects it. In the marketplace, however, they continue to be regarded as best of breed. The risk/reward is extreme in my view and a quarter or two of solid execution would be extremely meaningful for the stock price. We continue to maintain a large position in Box.

Housekeeping

1. We've added Interactive Brokers as a second custodian. For clients who don't get much value out of Schwab's retail network and additional services, I think they'll get a lot of value using Interactive Brokers as their custodian.
2. White Brook Capital Partners, a commingled fund, continues to get closer to launch. If you think you might be interested in investing in White Brook Capital Partners, please reach out.

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.

Sincerely,

A handwritten signature in black ink that reads "Basil F. Alsikafi".

Basil F. Alsikafi

Portfolio Manager

White Brook Capital, LLC

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