

# First Quarter 2021 Commentary

## Quarter in review

### Performance Review

| NAV increase, net | Inception | PF 2019 | 2020   | 1Q2021 |
|-------------------|-----------|---------|--------|--------|
| WBCP              | 74.37%    | 17.60%  | 19.05% | 25.42% |
| S&P 400           | 40.72%    | 9.11%   | 13.66% | 13.47% |

Inception of White Brook Capital Partners was August 16, 2019

Performance figures are provided by the administrator and are unaudited, PF 2019 is audited

Performance is net of all realized and accrued fees

### Portfolio Review

*Note: Experimenting this quarter. In addition to this letter, a short audio discussion of this letter's contents with a current limited partner is available for current and potential accredited investors [here](#).*

At quarter end, the Fund was 95.59% invested across 11 positions. The portfolio was up 25.42% net of all realized and accrued fees compared to the S&P Midcap 400 Index up 13.47% and the S&P 500 up 6.17%. The quarter was unusual in the breadth of outperformance. Since inception in mid-August 2019, the Fund is now up 74.37% vs 40.72% for the S&P MidCap 400 and 43.67% for the S&P 500.

During the first quarter, previously Undisclosed Position Y, which was Yext, Inc (YEXT) was the only substantive loss. Two other transient positions generated losses of less than 5 bps (.05%), cumulatively. Top contributors to the Fund during the quarter were Discovery Communications (DISCA & DISCK), Mosaic Co (MOS), and Box Inc (BOX). On a sector basis, communications was the top contributor to performance, and no sector detracted from performance.

As expected, portfolio turnover was elevated this quarter, but it was even more elevated than foreseen. This will likely result in a more substantive tax burden at the end of the year. I expect the amount of portfolio turnover to settle down as the year progresses.

Despite initiating a position in the fourth quarter, Alaska Airlines Group, Inc (ALK) was sold during the first quarter. The Alaska Airlines investment was envisioned to be a long-term investment, but the stock price appreciated more quickly than

expected. Like many other “re-open trades”, the value of the company including its debt now exceeds the value pre-pandemic. For that to be reasonable I’d have to believe:

- 1) The company/industry had too little debt and by adding debt they’ve better optimized their balance sheet for equity returns while still maintaining downside resiliency;
- 2) The company/industry’s profitability will be better moving forward than it was pre-pandemic and therefore warrant a higher multiple; and/or
- 3) The company/industry was significantly mispriced before the pandemic.

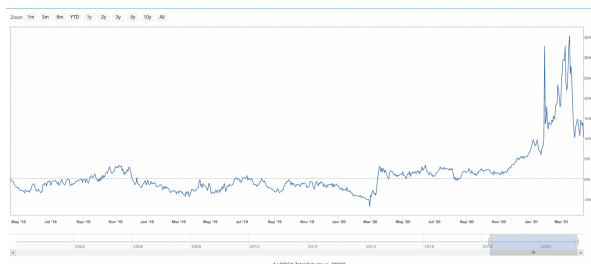
The first was true of Alaska Airlines pre-pandemic, but the certainty one can have about the second and third is not high enough to compel continued investment at today’s prices. The intended long-term position turned into a short-term trade with an exceptional IRR.

Broadmark Realty, Inc (BRMK), was sold because of competition for capital from new positions and other investments in the portfolio. The company will continue to do fine, but better short and long-term investment opportunities were available.

Discovery Communications voting shares (DISCA) were sold in favor of swapping the stake with Discovery Communications non-voting C shares (DISCK). Discovery has three classes of stock with varying voting power but that share equally in the economics of the business. We initially owned the class A voting shares, that have a single vote per share because they traded within the range of its historical premium to the C shares, and it’s usually inconsequential which one owns. This is because Discovery’s board of directors is populated with members loyal to Dr. John Malone, the largest individual shareholder - therefore a shareholder’s vote which typically advises the board is relatively meaningless.

During the quarter, the premium the A shares traded for expanded significantly from the historical ~5% to almost 20%.

This caused White Brook to swap our investment from the A shares to the C shares. We then continued to sell the stock as it increased in value, continuing



to have a significant, but not full stake as the stock doubled during the quarter. While a 30-50% rise in the stock price from where it closed last year seemed reasonable for the year, in excess of 50% was excessive and the ~130% rise at its peak was irrational. After selling much of the position for a very healthy gain, I held on to a stake until peer ViacomCBS took advantage of its own even more impressive rise by issuing equity to cure its over indebted balance sheet. Believing the bubble to finally be deflating, I sold our remaining position. Several days later, Discovery fell precipitously as an over-levered Fund that had recklessly bought Discovery, ViacomCBS and several other stocks fueling their rise, “blew up”. At quarter end the stock was up ~35% year to date (although it has appreciated considerably in the early days of this quarter).

Exchanging Discovery's A shares for C shares was the right move, despite the harmful tax consequences. Had we held the A shares for the exact same length of time, we would have made more money as 1) the spread between the A and C shares widened during our time owning the C shares and 2) the taxes of selling just our A shares would have been less significant than the long term capital gains we will endure on the A shares and the short term gain we recognized on the C shares. But by exchanging A shares for C shares, we owned the same company at a much cheaper price and it meant I could rationalize the price of the Company, longer. If it happened again, I would likely make the same exact trades. The process was correct, even if the outcome wasn't ideal. I continue to like Discovery's prospects, and we may re-enter the stock in the future if its valuation is again unreasonably cheap. It was a very good investment for the Firm even without the extraordinary run. The extraordinary additional returns added almost 1000 bps to gross performance (~35%) for the quarter or just less than a third of our gross outperformance vs the S&P 500.

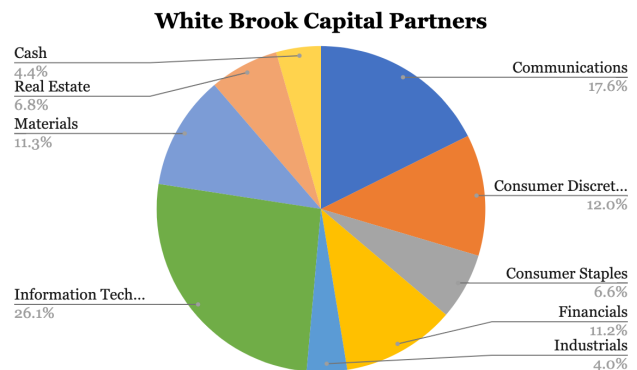
First Solar (FSLR) and Itron (ITRI), both of which I've written about in past *In Focus* sections were long-term positions that were sold as their prices exceeded price targets. Both are solid companies that remain on my watchlist, but the opportunity cost of not investing in other potential investments exceeded their potential mid-term returns.

Yext, Inc was sold as my estimation of its future was recalibrated following another quarter of misexecution. When building a position in Yext, it was my belief that after missing a couple quarters, they were at a point where if they could execute, the upside would be very rewarding. Following another quarter of misexecution and less

prime adoption of their product than expected, it seems more likely that the investment opportunity will be less robust than initially hoped.

At quarter end, the Fund owned new positions in Conduent, Inc (CNDT), Cogent Communications, Inc (CCOI), Post, Inc (POST), and Pitney Bowes, Inc (PBI). Having exited 6 stocks and entered 4, the portfolio is more concentrated than it has been recently. This is expected as the likelihood and magnitude of a rise in the overall market declines and market opportunities become fewer. That said, in my view, 85% of the portfolio has the capability to increase in value in excess of 50% and for a few much more than that. While one or more of the investments will likely disappoint, I believe much of the work of rebuilding the portfolio after the very rapid appreciation that occurred over the last year has been done. I like the risk-reward, attractive overall valuation, and business quality of each of the individual businesses in the portfolio. As a portfolio, I also like our prospects as the portfolio is fairly well diversified - for an 11 stock portfolio, with relatively uncorrelated adverse macroeconomic risks impacting each investment and therefore the portfolio as a whole.

At quarter end, the average size of a company in the portfolio had a market cap of \$6,683 million with a low of \$1,413 mm and a high of \$19,201 mm. This compares to the S&P Midcap 400 Index's minimum market cap of \$1,342 mm, maximum of \$16,079 mm and average of \$5,960. The Fund's investments were diversified over multiple industries.



## Market Commentary

The next quarter or two are likely to be irrational. During normal times, “The Market” is a great tool for humbling the overconfident as the market disproves investment hypotheses. That market mechanism will be turned off as the transition from a locked down to reopened economy means that every thesis is potentially true. The unevenness of the reopening due to different reopening schedules, infection rates, and bottlenecks within the transportation system will result in “great” or “great, if only” near term results by many companies. Inflation, real or presumed, will be debated

inconclusively with investors convinced of their righteousness even as near term data disconfirms either argument because the steady state economy is a year away. At the same time, potential and actual fiscal and economic stimulus is likely to impact the reopened economy's baseline. The result is that in the near term, those of us that price businesses live in a fantasy world where discounting current and historical results is appropriate for a broad portion of the economy. Beneficiaries from the work from home economy won't yet see a change in their business as any long lasting changes are gradually implemented. Those that benefit from a return to normal will note a tremendous rate of change even if the endpoint ends up less than they would presume. On this quarter's earnings calls, management teams really have no sense of what the future will be. It will make investing for the medium and long term potentially very different from the short.

## Midcap Update

As an update to a longstanding and self-serving thesis that midcap stocks have underperformed and are set to outperform - the opportunity in middle capitalization stocks continues to be significant and I continue to be a proponent of increasing exposure to midcap stocks. While White Brook Capital Partners has been able to exceed the performance of the S&P 500 since inception, the sector has not. Middle capitalization stocks have underperformed large caps since 2014, dramatically so since 2016. That is reversing and provides a tailwind for midcap managers like White Brook.



In my experience, midcap stocks are habitually overlooked with most focusing on the S&P 500 or the Russell 2000. The bull/bear nomenclature that dominates the S&P 500 stock discussion is ill fitting to smaller companies that most have never studied. My stand-in for a midcap shareholder is the Skeptic. The Skeptic owns the stock, but given that sell-side coverage is relatively scant of midcap stocks, and portfolio managers only half trust the analysts that work for them - he/she doesn't really understand the company and why certain attributes are important. They don't appreciate the risks, and critically may perceive strengths as weaknesses and are therefore willing to sell at the first sign of trouble. The job of a midcap write-up therefore is to educate the skittish

shareholder that the thing they own is far more valuable than what they thought either due to the quality of the business or the latent earnings growth potential. Prices after all are set by the seller.

### **In Focus: Conduent Inc (CNDT)**

During the 1st quarter, White Brook built a position in Conduent. Conduent operates in three divisions: Commercial, Government Services, and Transportation. The Government Services and Commercial divisions perform similar call center, processing, and administrative services. The Transportation segment also runs tollways and traffic ticketing systems. Their services are necessary, but typically non-core to their customers and can be done more cheaply by a scaled player like Conduent than could be done in house. The services are also unlikely to drive a customer's purchase decision although they significantly impact the customer's experience. Potential customers want someone with experience, that will do the job well, and don't want to think too much about it. Larger enterprises also need a provider that has the resources to scale as necessary (product launch) and monitor their employees. This is the business process outsourcing industry of which Conduent is amongst the largest.

Five years ago I would not have considered Conduent a potential investment candidate, ten years ago I wrote off investors for even suggesting it (Xerox). The Company was birthed by Xerox in December of 2016 by spinning assets from legacy Xerox and recently acquired Affiliated Computer Systems. After becoming public at ~\$15 per share, the stock traded to \$23 by the end of 2018 before beelining to a Covid low of ~\$2. During that time, the Company went through multiple chief executives and Board Chairmen and a fight with largest shareholder Carl Icahn that included a burn it all down letter from a board member in April 2019 alleging board malfeasance. That move ultimately resulted in Cliff Skelton's appointment to interim CEO, and his permanent appointment in February of 2020.

The corporate chaos was reflected internally as the company lost major contracts, was accused of bribery, and both customer and employee satisfaction deteriorated prior to Skelton's appointment. Since, a culture change has occurred at the Company. Overall employee satisfaction has improved significantly. With increased satisfaction, employee retention has improved, resulting in improved relationships with clients and an improvement in customer churn. After years of losing business, the company is finally

growing early indicators of revenue with new business signings and total contract values of new business growing. As a further sign of the different approach, customers that previously terminated relationships with Conduent due to non performance have not only reopened doors but awarded contracts to Conduent. From a financial analyst's perspective, the Company more routinely meets or exceeds earnings expectations. There's still more work to do, and the recovery is likely to be uneven, but Conduent has already turned around. As large contract losses under previous management finally roll off that will become evident to the uninterested as well.

There are additional tailwinds as well:

- There's potential for an accretive sale of one or more of its business lines. The Company engaged in a review of its businesses when Skelton became CEO pre-pandemic, but any subsequent process was cut short as global business activity deteriorated.
- The Company should be a beneficiary of a return to work, whether that be via processing toll and ticket fees or providing support for insurance carriers - buying near and medium term results.
- There's potential opportunity in keeping some of the workforce at home and rationalizing real estate. Employees on message boards seem to like the experience of working from home over working in a call center even over a year later. The industry as a whole could have a permanently lower cost base. It remains to be seen whether those savings would be passed on to the customer, but if so, it then expands the market and opens their services to a smaller business.
- Finally, during the quarter, management voted with their own dollars, buying a modest amount of stock in the open market at a time when most management teams are selling a portion of their holdings.

The Company trades at a double digit free cash flow yield and less than 6x next year's EBITDA - an appropriate multiple for a melting ice cube, but not a company that grows. I am excited by what the future holds for our investment in Conduent.

As I mentioned last quarter, last year I enacted White Brook Capital's business continuity plan. I continue to work from my home office and am evaluating whether this is an appropriate arrangement over the medium term. My personal productivity relies on blocking out the outside

world while being continuously but appropriately uncomfortable. Ironically at home I've been very successful executing on that. I continue to evaluate options as the world emerges from Covid.

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 cursive script that reads "Basil F. Alsikafi".

Basil F. Alsikafi  
Portfolio Manager  
White Brook Capital, LLC

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