The Blue Chips
Investor Letter
Fall 2018

"Uncertainty is the friend of the buyer of long-term values"

Warren Buffett

Statement from the Chair

Chairman of the Investment Committee: Rishi Krishnan

At first glance, the quote on the cover of this quarter's investor letter might appear puzzling. Traditionally, academic finance tells us that market uncertainty and its predictable consequence of volatility are synonymous with risk. In other words, securities should be less attractive as uncertainty increases. While this conclusion has merit in the abstract, Buffett accurately notes that a longer investment horizon can completely invert the relationship. The greatest bargains appear in moments of market mayhem; with a longer time horizon, the potential gains from compellingly mispriced securities outweigh the cost of volatility. Still, acting on this belief is no easy task. Attempting to catch a falling knife wiped out more than a few value investors in the past recession as short-term factors battered down prices. Yet, even for long-term investors with sticky capital, maintaining conviction in attractively-priced businesses when the market goes haywire presents a real challenge.

It would be difficult to mention uncertainty without commenting on the rollercoaster the market has been on for the past few months. The bull run of the last decade may be on its last legs. December was the worst month for the S&P 500 and Dow since the Great Depression. Several-hundred-point index drops and gains in a day have become common over the past several weeks.

In this tumultuous time, two flawed modes of thinking can become common. The first framework seeks to find meaning in every price swing. Market commentators never tire of attributing index movements to a rotating medley of portents including trade wars, interest rates, housing market woes, energy prices, and even bitcoin. Large scale macroeconomic factors undeniably affect business fundamentals, but it would be foolish to consistently legitimize the vagaries of the market. Sometimes, sentiment just shifts. The second viewpoint, the more common among value investors like ourselves, dismisses these movements as largely irrational and consequently not worth paying attention to. The simple fact is that prices also affect fundamentals. Sell-offs lead to challenging financing environments and payment terms, affecting the health of all businesses. As the many bank runs in this country's history illustrate, market concerns, justified or not, can destroy a company. Whether or not there is a fundamental reason for the market's uncertainty is immaterial to how seriously we should take it – we must assess and increasingly account for the effect a larger downturn would have on each of our investments.

BWX Technologies (NYSE: BWXT), our lone portfolio addition this quarter, reflects this understanding. BWXT's primary line of business is the design and manufacture of precision nuclear reactor components for the United States military's naval submarine program. It has been the sole supplier of these highly complex parts to the U.S. military for decades. Congressional appropriations for naval submarines are allocated years in advance and are essentially unrelated to greater market conditions. The government's interest in the existence of a single provider of these parts has accorded BWXT a virtually unassailable moat, leading to consistently high margins and returns on capital. We believe the main business line fully covers the valuation, with the company's auxiliary ventures that harness core technology providing a compelling upside. Even if macroeconomic conditions worsen, we are still confident that BWXT will remain strong.

Fall is always an exciting time for our organization. We welcomed 31 new analysts, the result of a much more comprehensive application process and a revamped NME curriculum of greater conceptual depth than ever before. Having now seen four years of new analyst classes, I am still amazed that each new class somehow, almost impossibly, manages to raise the bar. We are excited to see how they will shape the club in the upcoming years.

This investor letter contains each sector's pitch and Investment Committee decision, along with other updates about the portfolio. Please feel free to reach out to me at rishikrishnan@uchicago.edu with any questions.

As always, my heartfelt thanks to our dedicated members and alumni who make the incredible community we have possible.

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Fall Pitches

LeMaitre Vascular, Inc. (NASDAQ: LMAT)

Healthcare Sector Leader: Matene Alikhani

Company Overview

LeMaitre Vascular (LMAT) is a seller of niche vascular surgery devices directly to hospitals and care centers. Headquartered in Burlington, Massachusetts, the firm primarily distributes peripheral vascular disease implants and devices. Its sales are split across biologic implants (34% of revenue), non-biologic implants (10%), and disposables (56%).

Investment Thesis

The Healthcare Sector recommends a BUY in LMAT for the following reasons:

1. Current Financial Position: LeMaitre Vascular's business model is focused on strong organic growth driven by intelligent acquisitions in the vascular surgery space. The company's sweet spot is acquisitions in the $5-10mm range. Highly specialized products of this size are distributed across LeMaitre Vascular's 105+ person worldwide sales team, which drives sales growth through direct connections with vascular surgeons. As such, the success of LeMaitre Vascular's business model is contingent on its ability to expand organic growth for acquired product lines. With a current cash base of $52.9mm and no debt, LeMaitre is well positioned for future acquisitions or as a potential buyout target.

2. Niche Product Market: LeMaitre Vascular operates in an extremely specialized market. Worldwide, LeMaitre Vascular's products address about 20% of the $5bn peripheral vascular disease market. Of these sales, 98% are in sub-verticals with total addressable markets of less than $160mm and 72% are in markets they are the #1 or #2 producer. Larger device players, such as McKesson and Medtronic have focused on device segments with a larger TAM and higher margins, such as distribution and heart-related and therapeutic devices. The TAM of all LeMaitre's products address 3.3% of Medtronic's and 0.47% of McKesson's annual revenue. Capturing the entirety of the average LeMaitre device market would yield Medtronic and McKesson an additional 0.5% and 0.7% of annual revenue, respectively.

3. Acquisitive Business Model: LeMaitre's strong leadership represents a combination of expertise in vascular expertise and financial engineering. With 21 acquisition in the past two decades, LeMaitre describes itself as a "Vascular Mutual Fund." Small to medium sized acquisitions have driven growth while the size of acquisitions has grown along with LeMaitre. In the emerging endovascular space, LeMaitre prioritizes acquisitions oriented around intellectual property and onboarding R&D-focused employees. In addition, LMAT's business model is focused on keeping R&D expenditures low by spending excess cash on acquisitions, increasing margins and cash flow.

4. Low Risk Play: Strong existing product lines and lack of debt position LeMaitre well to weather any future challenges. Even assuming no organic/inorganic growth, LeMaitre's current product lines justify a significant portion of the share price. Due to the extremely niche status of the industry, several LeMaitre product lines are not patent protected. Assuming 0% product growth until 2032 and a decrease in expenses due to the recurring nature of its revenue and sticky customer base, the sector's zero growth model yielded 64% of the current share price. For a company focused on organic growth through acquisitions, forecasting zero growth is extremely conservative.

Key Risks and Considerations

1. Organic Growth Issues: LMAT management has struggled with an allograft tissue supply shortage and is unsure how to tackle this problem. The firm has increased recovery centers and are working on more efficient transfer of tissue.

2. Endovascular Trends: Over 80% of LMAT's revenues have been from open vascular surgery. The trend towards endovascular surgery represents a risk that the firm will not be able to capture changing market trends. However, LMAT has expertise in purchases and a strong history of acquisitions.

Decision: NO PURCHASE

Healthcare Investment Committee Representative: Sam Zager

The Healthcare Sector pitched LeMaitre Vascular, Inc. (NASDAQ: LMAT) on Wednesday, October 24th, 2018 in general meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase LMAT. Our reasons are as follows:

FIRST: We are not convinced LMAT's acquisition strategy will allow for sustainable inorganic growth moving forward. For many years management guided towards a 10% sales and 20% operating profit annual growth target, but recently abandoned this target, citing flagging acquisition prospects. We believe there is significant risk that this slowdown is not an aberration but is instead due to increased competition and LMAT's saturation in target markets (discussed below). Since most of the company's value comes from future growth expectations, this slowdown bears a significant impact on the company's valuation that we believe the market is accurately assessing.

SECOND: Though LMAT smooths risk across different products, it does not have clear barriers to entry across its product lines. This is evidenced by recent competitive pressures that have materially impaired the business. Earlier this year, management cited new competition in the biologic implants segment that has created pricing pressure and limited market share growth. Additionally, rather than serving as a barrier to entry, the company's sales strategy can actually harm organic growth. In its recently-acquired Restore Flow Allograft (RFA) product line, LMAT's attempt to replace existing distributors with their sales channel led to RFA customers switching allograft products to stay with their old distributors. Niche product lines and high market share are not compelling moats in-and-of themselves and we are not sufficiently confident in LMAT's ability to fend off growing competitive pressure.

THIRD: LMAT's rollup strategy creates a significant risk for a market overvaluation of its acquisitions. LMAT purchases smaller companies at attractive multiples, which are then reevaluated at LMAT's multiple, causing immediate and potentially artificial price appreciation. Without more granular information on acquisition multiples, we are concerned about the potential for financial engineering to inflate business results.

Dollar Tree, Inc. (NASDAQ: DLTR)

Consumer Sector Leader: Melaina Rapisarda

Company Overview

Dollar Tree (DLTR) is a leading operator of discount variety stores in the U.S. and Canada, operating under the banners Dollar Tree (~6,650 stores) and Family Dollar (~8,185 stores). While both banners contribute about 50% to revenue, DLTR generates 74% of operating profit while Family Dollar earns the remaining 26%.

Investment Thesis

The Consumer Sector recommends a BUY of DLTR for the following reasons:

1. DLTR is a recession resilient and fundamentally sound business: DLTR is well-positioned to capitalize on a weak economy as it becomes more attractive to lower buying-power consumers by accepting food stamps and offering cheaper alternatives to consumer staple products. In 2009 DLTR's revenue and operating income grew 12.6% and 40.1%, respectively. It has also proven its ability to grow in a healthy economy. In the last five years, the company has achieved positive SSS growth each year, an average of 18.3% ROIC, and superior EBITDA margins to its peers.

2. Market is valuing DLTR as if FD was almost non-existent: DLTR has lost ~30% of its value since the end of January due to earnings misses and negative investor sentiment around the 2015 FD acquisition. Although Dollar Tree is fundamentally a better business than FD given higher margins and return on capital (~30% historically), we do not believe the segment is necessarily destroying value. Since the acquisition, FD has seen sales and gross profit growth and has turned an operating loss into a 5% operating margin. A comps analysis implies that the Dollar Tree segment of the business comprises ~73.4% of the total value of the business, despite FD generating nearly 50% of revenue, 26% of operating income, and possessing 74.8% of the total assets of the business. Although FD is not the crown jewel of the business, it is a large and profitable portion that is expected to generate growth and margin expansion in the near term.

3. Business model uniquely resilient to threat of e-commerce: DLTR differentiates itself from other e-commerce players through its focus on smaller, need-it-now purchases that primarily fall under consumer staples. As a result, the company positions itself to capture the "midweek shopper" searching to replenish essentials. These shoppers accept the "no-frills" stores of DLTR and expect neither high quality nor quantity of products – the basket price of DLTR is about $12.14, with customers buying around 11-20 items in aggregate per trip. These purchases are just too small to justify shipping costs on both the buyer's and seller's end and thus deter other e-commerce giants, like Amazon or Jet, from competing in this highly discounted market.

4. Multiple catalysts to help market realize undervaluation: We believe DLTR is capable of beating earnings as early as Q4 2018 by better integrating FD into its core business through store renovations, renegotiating expiring supplier agreements, and consolidating Dollar Tree and FD distribution centers. Another catalyst would be a sale of FD. In mid-October, Carl Icahn purchased a large stake in DLTR. Icahn was FD's largest shareholder in 2014 and pushed for the sale of FD, though preferred Dollar General as the buyer. We believe his presence increases the possibility of a FD sale, but also serves as a buffer against future mismanagement of the FD integration process, if a sale does not occur.

Key Risks and Considerations

1. Sustainability of the $1 Model: Inflation increases input costs and decreases margins since prices are capped at $1/$10. This is partially mitigated by DLTR's strategy of purchasing excess supply and distressed goods from suppliers that mainstream retail chains do not buy from. DLTR also sells items that are less sensitive to inflation like clothing, consumer electronics, and household goods.

2. Chinese Trade War: USTR is considering implementing an additional 10%-25% tariff against Chinese goods. Although only 9% of DLTR products would be affected by these tariffs, increased costs would meaningfully decrease profitability in the event of simultaneous inflation and weakened store-traffic.

3. EVA valuation demonstrates reliance on DLTR's continued profitability: An EVA suggests that ~80% of value comes from the Dollar Tree segment, which earns an estimated 34% ROIC. If DLTR is unable to earn a comparable ROIIC on new/renovated stores moving forward, its valuation will be significantly affected.

Decision: NO PURCHASE

Consumer Investment Committee Representative: Katherine Gerdes

The Consumer Sector pitched Dollar Tree, Inc. (DLTR) on Wednesday, October 31, 2018 in General Meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase DLTR. Our reasons are as follows:

FIRST: We believe that the Family Dollar (FD) segment is a struggling business with no competitive advantages that is currently destroying value. The unattractiveness of the FD segment is currently being priced in and we have found no sufficiently convincing reason to believe in a turnaround of this segment. We are more than 3 years out from the acquisition of FD, so we believe that synergies have been largely exhausted. FD's largest competitor, Dollar General (DG) has significantly outperformed FD in terms of SSS growth over the past 5 years, and DG has operating margins that are nearly twice FD's. We are unconvinced by the sector's argument that FD will be able to match DG's growth and margin profile in the future. In terms of growth, over the past few years, DG's SSS growth has accelerated while FD's has slowed, indicating that DG is actually winning traffic from FD. Furthermore, DG is opening ~900 stores per year and aggressively expanding in close proximity to existing FD stores to poach customers. As it stands, 45% of FD stores are within 1 mile of a DG store and 78% are within 3 miles. We believe this direct competition will only intensify going forward. DG has lower prices than FD (7% lower across all products and 9% lower on food), the products sold are completely commoditized, and the target customer is very price sensitive. Therefore, we find the sector's view that FD will be able to accelerate SSS growth while expanding margins to be too optimistic. FD will likely have to choose between lowering prices and sacrificing margins or accepting a drop in traffic.

SECOND: While the Dollar Tree segment's fixed price point model has historically allowed the company to carve out a profitable, attractive niche in retail that is largely immune to the threat of e-commerce, this business model is coming under pressure and could become less viable in the near future. Trade conflicts and inflation pose a serious threat to DLTR's margins, since both increase the company's cost of goods sold and it is unable to pass these increases on to its customers. In addition, DLTR's model relies heavily on impulse purchases. DLTR purposefully places their stores in strip malls anchored by large retailers who draw target customers that are similar to DLTR's, relying on the fact that shoppers visiting the mall will be tempted to visit the DLTR store as well. Due to the proliferation of e-commerce, malls in the U.S. are currently experiencing a secular decline, even in the midst of an economic expansion. We are concerned that this decrease in mall traffic will cause a decrease in DLTR's traffic as well, causing revenue growth to slow. A decrease in foot traffic is a serious threat to DLTR, since unlike other retailers, DLTR cannot just switch to selling directly to customers online, since as the sector noted, the average basket size is too small to justify shipping costs.

THIRD: The valuation is heavily reliant on DLTR's ability to maintain a high ROIC going forward. Historically, DLTR has had a very high ROIC, but if it has to invest a lot in keeping FD afloat, the company's incremental ROIC could be much lower than their historical ROIC. The fact that management chose to acquire FD instead of reinvesting in their business is an indicator that DLTR is either very concerned about intensifying competition or is running out of attractive reinvestment opportunities, both of which are concerning.

BWX Technologies, Inc. (NYSE: BWXT)

Industrials Sector Leader: Richard Archer

Company Overview

BWX Technologies' primary line of business is the design and manufacture of specialty nuclear components for the U.S. government, including precision naval nuclear components, reactors, and fuel. The company also has a Nuclear Services segment, which includes nuclear material processing, environmental services, and general inspection and maintenance. Finally, BWXT operates a Nuclear Power group, a more commercially-oriented sector that produces fuel and equipment and provides other commercial services.

Investment Thesis

The Industrials Sector recommends a BUY of BWXT for the following reasons:

1. Monopoly/monopsony industry configuration provides deep barriers to entry: While severe customer concentration represents a risk, we view this industry structure as highly favorable overall. The government's aversion to disseminating highly classified information has allowed BWXT to operate as a legal monopoly for decades. Moreover, it is efficient from the government's perspective to have one supplier of such R&D intensive components, which further supports the natural monopoly. The government is price insensitive and dependent on nuclear equipment of the highest quality – this incentivizes the government to fund more of BWXT's R&D, reinforcing the company's superior industry positioning.

2. Largely uncorrelated with greater macroeconomic risks: We do not pretend to have the ability to predict market downturns, but we do know that ten years into an economic expansion, it benefits the club to structure the portfolio with a possible downturn in mind. The performance of many traditional industrials companies is inextricably tied to macroeconomic indicators, and we think that the benefit of being significantly less exposed to macroeconomic cycles outweighs the cost of being highly exposed to a single client and general exposure to political risk.

3. Cores business provides technology expertise for ancillary ventures: In many areas the government is incentivized to contract work out to the lowest bidder. However, in high risk areas like nuclear submarines, the government has demonstrated a willingness to fund a high level of R&D – that is, contracts are often structured not to incentivize cutting corners and cost savings. BWXT is now in a position to use that expertise to enter related but distinct markets, such as medical isotopes in the next 2-3 years and small modular reactors in the next 4-5. We think that this growth opportunity is largely not reflected in BWXT's current valuation and will provide upside going forward.

Key Risks and Considerations

1. Extremely high customer concentration: The U.S. federal government accounts for about 80% of BWXT's revenues. This risk is mitigated to some degree by the fact that BWX deals with multiple distinct entities within the government, including but not limited to the Department of Defense, Department of Energy, the Office of Nuclear Energy, and the National Nuclear Security Administration. We have analyzed contract structure to the best of our ability and believe that the government will continue to grant BWXT exclusive control over a material volume of high margin work, but we would be remiss not to acknowledge the significant risk posed by customer concentration. This point includes the political risk posed by a general reversal in the historical trend of increasing military expenditures.

2. Timing and delays: We are confident that in all but the worst of downside scenarios the government will not replace BWXT or eliminate its monopoly status, as would be the risk with a typical project-based company. Rather, if BWXT were to make a material mistake on a project, payment could be delayed until completion, and a multi-year delay could have material adverse effects on value. BWXT often receives financial rewards for jobs completed ahead of schedule, so if BWXT were to run into delays, margins could be compressed and payments delayed. This is in addition to the risk that government shutdowns and budgeting issues could delay payment regardless of BWXT's performance.

3. Columbia-class Ballistic Missile Submarine Program: It was recently reported that there have been issues with the welding on a BWXT contract. Management has reported that it believes with will amount to a possibly material delay in recognition of revenues and receipt of cash flows, but that the issue was self-reported and primarily related to the inspection of the welds rather than the process itself. We believe this largely mitigates this risk, which will amount to a delay rather than a deterioration in the business.

Decision: BUY

Industrials Investment Committee Representative: Liam Zhao

The Industrials Sector pitched BWX Technologies (NYSE: BWXT) on Wednesday, October 31st, 2018 in General Meeting as a Buy with a 5% position. The Investment Committee (ICOMM) decided to follow the recommendation and purchase BWXT at the time of recommendation. After further deliberation, we agreed with the sector's thesis that BWXT has strong competitive advantages within the U.S. military nuclear-components market. We believe BWXT's core business accounts for most of the valuation with asymmetric upside potential from its recent growth into ancillary markets. With high valuations and uncertainty in the current market, BWXT presents itself as a relatively safe investment due to its ability to generate consistent and predictable cash flows that are insensitive to the macroeconomic environments (given its industry dynamics and contract structure). BWXT is an attractive investment for our portfolio for the following reasons:

1. Monopoly position in a favorable industry: BWXT's largest segment, Nuclear Operations Group (which accounts for ~81% of total revenue and ~91% of total income as of Q2'18), solely supplies naval nuclear reactors for the U.S. Department of Energy ("DOE") and Navy. These naval nuclear reactors manufactured by BWXT are used for power generation in submarines and aircraft carriers, and thus BWXT does not compete with larger shipbuilders such as GD and HII. Operating in this industry is advantageous for BWXT for several reasons. Given the technical expertise required (limited human capital), high R&D costs, government regulation, long contract duration and importance of relationships (past contracts help win future contracts), BWXT is and will continue to be the only dominant player in the naval submarine nuclear reactor space. In addition, the U.S. Department of Defense ("DoD") is also price insensitive due to the strategic importance of high-quality nuclear reactors and fully covers R&D costs of contractors with a 10-15% profitability per contract. Thus, BWXT is positioned to generate consistent cash flows given its predictable backlog and contract structure. Furthermore, U.S. military spending is dictated by DoD budget plans and Congressional approval and has historically largely been independent of macroeconomic trends (military spending actually spiked during the 2008 financial crisis). This allows BWXT to deliver stable performance even in the case of a market downturn.
2. Stable demand and predictable growth: In the foreseeable future, BWXT faces growing demand from all three of its operating segments. BWXT's Nuclear Operations Group's top-line will benefit from the $160 billion increase in defense spending from DoD's budget request in March 2018, as well as the U.S. Navy's 30-year ship building plan that aims to reach a 355-ship fleet by FY 2050 or even earlier (59.3% of total funding goes to ship types that are powered by nuclear reactors). In addition, the Nuclear Power Group, which designs and manufactures commercial nuclear generators and other related components, will continue to grow in the Canadian market from increasing recurring and refurbishment demands. Although the Nuclear Services Segment had some fluctuations in revenue over the past twelve months, these variations are largely due to the timing of maintenance outages. Given recent contracts and backlog, we expect the Nuclear Services Segment to contribute to revenue growth in the next 3 years as well.
3. Fairly valued with asymmetric upside potential: As of Q2'18, BWXT is valued at a forward EV/EBITDA of 15.5x and a forward P/E of 22.5x. Although the multiples are ostensibly high, taking into consideration of the company's high ROIC and low WACC, the sector comes to an implied multiple of 12.2x for the company using existing contracts. A DCF of just the Nuclear Operations Group based on approved Naval submarine construction plans covers the entire value of the company. Compellingly, BWXT's growth into small modular reactors ("SMR") and Nuclear Medical Radioisotopes ("NMR") markets provides upside to the valuation. Using a rough top-down valuation, the sector estimates that these new markets will be able to generate an upside of ~$8.3 per share (which was ~14% of the share price at the time of recommendation). Although it is difficult to pinpoint the exact valuation of BWXT's expansion into these new markets, given that management has not released specific top or bottom-line guidance, we believe this asymmetric upside potential outweighs the idiosyncratic risks of the company.

Key Risks and Considerations

1. Inability to pass on potential increases in costs: Since all of the Nuclear Operations Group's revenue is contract-based, any increase in costs such as inflation or raw material costs will erode the company's margin and profit. Since contract execution can take up to 7 years, the company might incur rather long-period of low margins due to these costs increases. Nevertheless, BWXT attempts to factor the costs of inflation, raw materials, labor and other related factors

into its original contract agreement, thus lowering the risks of unexpected margin impacts. In addition, from a more general level, shipbuilding inflation tends to be higher than GDP price inflation in the long-run, which reduces this particular risk as well.

2. Uncertainty in contract renewal and revenue realization: Since BWXT's only customer for the Nuclear Operations Group is the U.S. government, BWXT faces severe customer concentration risks. First, although BWXT has clear and defined contracts with the DoD, Congress appropriates funds on a fiscal-year basis. This means that even though a contract might last several years, Congress has the power to reduce the funding for that contract or even terminate it. In addition, since revenue is realized on a percentage completion basis, any delays in progress will lead to lower-than-expected revenue realized for that certain period. For instance, BWXT had welding issues on missile tubes in Q2, leading to delays in manufacturing progress and the company eventually missing its EPS target. However, BWXT has been able to consistently realize its projected backlogs since its spinoff in 2015 and Congress has never decreased funding for a contract that BWXT was working on. As for uncertainty in revenue realization, though there is no mitigating factor for this risk, the missile tube welding issue is the first case of project delays that management has discussed and has not led to risks to other projects or of contract cancelation.

3. Threat of alternative energy sources: BWXT also faces the risk of increasing demand for alternative energy sources over nuclear energy, which would impact its Nuclear Operations Group and Nuclear Services Group. Due to threats in profitability including the boom in the U.S. shale gas market, commercial nuclear power has recently experienced negative headwinds in both U.S. and Canada. However, a mitigating factor is that decommissioning nuclear plants is very expensive and damaging to the environment. BWXT's segments related to commercial nuclear power are primarily maintenance and fuel-related, and strict regulatory guidelines and high exit costs for nuclear plant operators will deter customers from switching away from BWXT's services.

Addendum from Industrials Sector

Within two days of executing our purchase order, BWXT released its Q3 2018 earnings and its stock price fell 24% to $46.26 per share. Contributing factors included a $0.21 charge related to the Columbia class welds for Q3 (although management insists that there will be no further charges going forward relating to this error), a delay in BWXT's entrance into the medical isotope market from mid-2019 to early 2021, and alterations to FY 2018 guidance (revenue guidance was narrowed from $1.75bn-$1.85bn to $1.8bn, EPS guidance was adjusted to $2.23-2.27). These factors, when combined, cannot account for the size of the price drop, but we hesitate to resort to explanations of widespread irrationality. This leaves us with the conclusion that this error has caused the market to reevaluate the risk inherent in BWX's contracts with the federal government and to reassess the multiple that this work should command. Although the issue is dramatic and not to be ignored, we do not think that this fundamentally breaks our thesis and will continue to hold BWXT – we believe that as BWXT works out these short-term issues and sees earnings growth, the market will reassess this multiple.

EZCorp, Inc. (NASDAQ: EZPW)

Financials Sector Leader: David Ozen

Company Overview

EZCorp is the second largest public owner and operator of pawn shops, with major operations in the US and Latin America. The company makes high-yield consumer loans backed by collateral, typically nominally small hard assets. If the loan is defaulted upon, the pawn shop seizes the collateral to sell. EZPW's LTVs vary from 40% to 70%, with loan terms lasting between 30 and 90 days and APRs between 158% and 304%. Interest and service fees account for the majority of revenue.

Investment Thesis

The Financials Sector recommends a buy of EZPW for the following reasons:

1. Latin American Expansion: In recent years EZPW has been expanding into the Latin America market, acquiring 196 stores in FY 2017. We believe this continued expansion will help drive topline growth, as Latin American market conditions are favorable regardless of the macroeconomic situation. 65% of Latin Americans are financially underserved, with over 250 million individuals lacking access to traditional bank and credit card debt. The Latin American pawn industry is fragmented, mostly consisting of small chains and one-off shops. Additionally, Latin American pawn shops traditionally only operate in the jewelry space, whereas EZPW's specialty is in merchandise loans. We believe that EZPW will continue to successfully execute their acquisition strategy in Latin America, with acquired stores expanding margins by using EZPW's Point-of-Sales system and transitioning from accepting exclusively jewelry to both jewelry and merchandise. This hypothesis has already begun to play out, with Mexico EBITDA margins expanding from 19.2% in FY '17 to 21.2% in FY '18.

2. Bottom of the Cycle: In a strong economy, pawn shops struggle because individuals have more access to traditional credit and consumers are not purchasing discount goods from pawn shops. With credit card default rates low (reflective of the availability of traditional credit), EZPW's ROIC has declined. We believe now is the optimal time to invest, as when the cycle turns EZPW should see increased interest revenue and, in the case of default, more inventory to sell as demand for inferior goods increase. EZPW is still being unfairly punished by the market for its payday loan practices (which resulted in a shareholder lawsuit), when the company has recently divested its unprofitable payday loan business and restructured costs. As a pure play pawn shop owner with a new streamlined cost structure, we believe that margins will increase across the board, with the company uniquely positioned to benefit from a turn in the cycle.

3. Trading at Unreasonable Discount to Peer: There is no denying EZPW has historically performed worse than its other larger competitor in the industry, First Cash (FCFS). That being said, we believe the current discount EZPW trades at compared to FCFS is unreasonable. Both businesses lack a substantial moat against each other. In 2018, EZPW's ROIC converged with FCFS's as cost cutting and their pure play strategy has payed-off. EBITDA Margins for the two businesses also continue to converge. EZPW has 13% more pawn loans outstanding (PLO) per store in the US, 6% more sales per store, 28% more PLO per store in Latin America, and a higher pawn loan redemption rate than FCFS. We expect these strong unit economics will benefit EZPW as they continue Latin American expansion. By all metrics, EZPW and FCFS are very similar businesses, yet EZPW trades at an 8.4x Forward P/E vs. FCFS's 18.5x. One might argue that FCFS is currently overvalued, but EZPW is certainly unfairly valued and punished relative to its peer.

Key Risks and Considerations

We found two crucial risks to our investment thesis.

1. Management risk: EZPW is majority controlled by Phillip Cohen through its Class B voting shares. Cohen and the company were subject to a shareholder lawsuit over company payments to a consulting firm owned by Cohen. He lost the suit, the contract was canceled, and management rearranged. Cohen is now forced to act as a fiduciary of all shareholders, though this is largely a slap on the wrist.

2. Convertible Bonds Dilution: All of EZPW's outstanding debt is in convertible bonds due in 2019, 2024, and 2025. Currently none of the bonds are in the money. If the 2024 bonds are converted, shares outstanding will increase by 20.88%. EZPW has an agreement in place to buy back all shares created if the 2019 bonds are converted, but it seems improbable a conversion will occur. Finally, the 2025 bonds would require over a 60% increase in stock price to be in the money, so there exists little risk of dilution within our investment timeline.

Decision: NO PURCHASE

Financials Investment Committee Representative: Abhi Sharma

The Financials Sector pitched EZCorp (EZPW) on Wednesday, November 7th, 2018 in General Meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase EZPW. Our reasons are as follows:

FIRST: While we were encouraged by EZPW's advantageous characteristics within its chain model, the lack of a structural moat means that they would face significant headwinds to the growth and maintenance of their market share. This concern, compounded by EZPW's focus on growth within highly competitive markets through heavy acquisitions (such as Mexico City), makes us wary about future competitive pressures within the industry. While the counter cyclicality of pawn shops is attractive, the highly competitive nature of the business as well as its no-moat characteristic creates significant uncertainty surrounding the potential for growth in the future.

SECOND: We also remain concerned about growth prospects in a highly fragmented Latin American industry. Specifically, pawn shops operate through local relationships; in order to be profitable within the business, EZPW needs to not only increase penetration through more profitable, small format stores, but also needs to navigate through the highly competitive, relationship-based Latin American market. We are not convinced that some of the advantages EZPW possesses in other geographies, such as models to assess customer risk and collateral value that are built on years of data, will be transferrable to new markets. We also remain concerned about EZPW's ability to successfully expand in Latin America due to the competitive pressures presented by First Cash and the several other smaller players. Relative to First Cash, EZPW has been largely unable to drive long-term margin expansion – we believe First Cash will outcompete EZPW in these new markets if this trend continues.

THIRD: We are especially concerned about management's incentives being skewed toward short-term EBITDA growth. Particularly, management's compensation structure is largely dependent on fulfilling short-term profitability goals while sacrificing its long-term commitment to the business. EZPW's growth through expensive acquisitions of large format stores especially highlights the effects of the skewed compensation structure towards short-term gratification.

Zillow Group, Inc. (NASDAQ: ZG)

Tech, Media, and Telecom Sector Leader: Henry Gao

Company Overview

Launched in 2006, Zillow is a real estate and rental marketplace that serves the full lifecycle of owning and living in a home. The company has accumulated more than 110 million homes in its database, attracting 190 million monthly active users (MAU). Zillow monetizes the platform mainly through advertisement from real estate agents, mortgage brokers, and other service providers. The company recently launched "Zillow Homes", which directly buys and sells properties. Although cash flow negative, Zillow has grown revenue by more than 25% every year, with trailing twelve-month revenue of $1.3 billion.

Investment Thesis

The Tech, Media & Telecom sector recommends a BUY in ZG for the following reasons:

1. Strong Network Effects and Dominant Market Position: The marketplace business model creates strong network effects by connecting users and advertisers. A large user-base and over 6.0x ROI on advertisement spending continuously attract more advertisers and higher expenditures. This network effect can lead to "winner-takes-all" industry dynamics, which serves Zillow as the industry leader. The real estate advertisement industry, served by Zillow's core business, has an estimated TAM of $17 billion and proven resilience against housing market downturns. Zillow is by far the dominant player among direct competitors without considering growth from acquisitions. Compared to the closest competitor, Zillow has ~8.0x MAU at around 190 million users and ~7.0x website traffic at around 28% of total visits.

2. Unique Economic Moat: Through user uploads, government sources, and third-party vendors, Zillow has accumulated 20 years of data, including a significant amount of proprietary data, on 110 million properties. As a result, Zestimate, its appraisal service, has become the de facto method of pricing homes cited by government agencies, academia, and others.

3. Asymmetric Upside Potential with Zillow Homes: Through Zillow Homes, the company directly taps into the $1.8 trillion home transaction industry. In this new business segment, Zillow continues to work with real estate agents and increases revenue from leads. The company strictly enforces a 90-day turnover rate to minimize balance sheet risks. Most importantly, Zillow leverages its database as an information edge and effectively acts as an informed market maker. For instance, when Zillow decided to purchase a property, it had already identified 5,000+ potential buyers with specific preferences matching that property. With conservative assumptions, this can materialize as 20-35% upside potential.

4. Attractive Buying Opportunity: The market has been pessimistic about the introduction of Zillow Homes, as evidenced by the relationship between Zillow Homes announcements and stock price drops. In the short term, this new business segment requires significant capital investments which will delay the company's profitability. However, we believe this is Zillow strengthening its operating leverage for greater profitability in the long-term. As a result, Zillow trades at a two-year low and the market is currently pricing Zillow Homes at either zero or negative. This marks an attractive entry point where we can realize Zillow's long-term value with a longer time horizon.

Key Risks and Considerations

1. Failure in Zillow Homes: Despite the massive addressable market, the new business segment has lower profit margins and would potentially cannibalize Zillow's core advertisement business. Since the Zillow Homes segment requires principal transactions, the low profitability implies low margin of errors on these home purchases in order to control liquidity risks. Zillow Homes also seems to be effectively cutting out the participation of real estate agents, which could cause backlash and hurt the core advertisement business.

2. Uncertainty with Profitability: Uncertainty around when Zillow would turn profitable significantly lowers our confidence in the valuation. Zillow has been building up its operating leverage in the core business through heavily investing in infrastructure and data analytics. The introduction of Zillow Homes and the relevant capital investments obscures the realization of the operating leverage in the core business. We believe that the core business has just begun to realize profitability, but is burdened by Zillow Homes. This could just be a timing issue in the optimistic case, but could also suggest that Zillow Homes is value destroying in the worst scenario. Depending on the EBIT margin in the terminal year, we could be paying up to 30x EV/EBIT (assuming 5% EBIT margin) for Zillow, which significantly cuts into our margin of safety.

Decision: NO PURCHASE

Tech, Media, and Telecom Investment Committee Representative: Nick Nigro

The Technology, Media and Telecommunications sector pitched Zillow Group, Inc. (ZG) on Wednesday, November 21, 2018 in General Meeting as a Buy. The Investment Committee (ICOMM) decided not to purchase Zillow. Our reasons are as follows:

FIRST: Zillow is impossible to value with any sort of precision. Currently, the company trades at a trailing EV/EBITDA multiple of 49.6x and a trailing EV/Revenue multiple of 3.9x. This in of itself isn't particularly worrying. Typically, we would be willing to pay a premium EBITDA multiple for a rapidly growing company with strong network effects that operates in a large market, as long as that company trades at a reasonable revenue multiple and exhibits significant operating leverage. But the ability to realize operating leverage is critical here. In the case of Zillow, we agree with the sector that the company has a strong network effect and attractive growth prospects; however, we are concerned with Zillow's ability to realize operating leverage. Over the past four years, Zillow's technology and development expenses have grown alongside revenues (from 29% of sales in 2015 to 31% of sales in the previous nine months). Although the company doesn't go into detail about why this is the case, we believe it is because of the company's significant investments outside of its core business—particularly, in its new segment Zillow Homes. The sector argued that Zillow's core advertising business justifies the majority of its valuation, and that by investing in Zillow, we are essentially getting Zillow Homes for free. We are concerned that Zillow's investments in Zillow homes (and in other points of integration in the homebuying process, like mortgage origination), will continue to prevent the company from realizing any meaningful operating leverage, which will in turn constitute a significant drag on value if these investments aren't as profitable as expected. Thus, for us to feel comfortable investing in Zillow, we would need to feel confident in Zillow's ability to succeed in the new markets it is entering.

SECOND: We aren't currently confident in Zillow's ability to succeed in its Homes segment. Zillow's Homes business is currently in its infancy. As a result, our view of the business must be based on our expectations for how the industry will function when it reaches a more mature state, not on the current financials/performance of the business. The sector's thesis for Zillow Homes is fairly straightforward. A market maker in homes can achieve an advantage over its competitors through: 1) better data, 2) better analysis/algorithms, or 3) greater scale. Zillow is the largest player in the online real estate industry and possesses a significant competitive advantage in the form of their proprietary data. Thus, it makes sense that the company would be well-positioned to dominate the real estate market-making industry as well. Intuitively, this thesis makes sense but the market action is completely inconsistent with it. The sector argued that the market is putting little-to-no value on Zillow's Homes segment. Yet, the sector's long thesis for Zillow Homes doubles as a short thesis for OpenDoor, which has recently raised $400 million from Softbank at a $2 billion valuation. Similar dynamics can be seen at play with Zillow's other competitors in the Homes segment. Thus, the market action (a high valuation for Zillow Homes' competitors and low or negative valuation on Zillow Homes) is completely opposite to what we would expect based on our thesis (a higher valuation for Zillow Homes and a lower valuation for its competitors). Although great investments are built on contrarian views, we feel uncomfortable taking such a contrarian view in a market which we don't feel we understand particularly well.

SolarEdge Technologies, Inc. (NASDAQ: SEDG)

Natural Resources Sector Leader: Kevin Ren

Company Overview

SolarEdge is an Israeli firm founded in 2006 that designs, develops and sells power optimizers, inverters, and a cloud-based monitoring platform for solar photovoltaic cells. Their end markets include residential, commercial, and small utility scale solar installations. SolarEdge outsources manufacturing to partners for a capital-light business model and has 49.5% of its revenues in the US, with the remainder in Europe and Asia.

Investment Thesis

The Natural Resources Sector recommends a BUY in SEDG for the following reasons:

1. SolarEdge operates at an advantageous position in the supply chain of the fast-growing solar industry: We view the transition towards solar energy as a secular trend still in its early innings, with a long runway to go. The MLPE market is forecasted to grow at a 15% CAGR, with significantly higher margins than other parts of the value chain. SolarEdge has historically been a market share gainer, outpacing the already high double-digit industry growth rate. Due to its positioning in the value chain, SEDG benefits from switching costs which solidify its competitive advantages and will help to maintain 20-30% ROIC.

2. SolarEdge shares have been excessively punished as a result of tariff fears: Recent Trump tariffs on solar panels and inverters have caused a massive sell-off in solar stocks, providing us with an attractive opportunity to engage in time arbitrage. Tariff impact will last no more than 3 quarters; SolarEdge has a strong response in the form of simply shifting its global manufacturing sites and redirecting shipments to avoid tariffs. We believe that key competitors are likely to be disproportionately hurt by the tariffs compared to SEDG. Additionally, SEDG has shown ability to exert pricing power to negate the impact of tariffs on operating profits.

3. Recent Acquisition of Kokam provides significant opportunity for growth with little to no downside risk: Kokam, a Korean battery manufacturer, was recently acquired by SEDG for $80M. The battery industry for solar PV energy storage is in a nascent stage, with a forecasted 11% CAGR over the next 5 years. High-quality batteries are naturally synergistic with solar installations, and SEDG projects a 30% attach rate conservatively. Battery add-ons for both new and previous installations significantly expand SEDG's TAM and increases switching costs. The Kokam acquisition allows SEDG to provide the full suite of solar solutions and could add over $350M of revenues within a few years.

Key Risks and Considerations

1. US policy regarding tariffs. Although we believe that tariffs have offered us an attractive entry price and will hurt competitors more, there is still significant uncertainty regarding future tariff decisions and their potential impact on SEDG.

2. Falling solar incentives. Federal and state incentives for solar are in decline and have historically helped bolster solar installations in the US. Currently the Investment Tax Credit is 30%, and it is set to decline to 10% by 2022. We believe this risk is mitigated by the increased efficiency and decreased pricing of solar panels (importantly not inverters/optimizers) as a result of technological development, which will counteract falling incentives. Additionally, SEDG continues to transition away from the US market, and Europe incentives continue to encourage solar through renewable energy mandates.

3. New competitor in Huawei. Huawei has recently attempted to replicate SolarEdge's inverters, and SEDG responded by engaging in a patent infringement lawsuit with Huawei in Germany. Primary research with solar installers suggests that Huawei's product is still technologically lacking, with missing features, non-durable construction, and lack of an emergency backup as key complaints. Huawei is also facing significant pressure both in the US and internationally over forced technology transfers and IP infringement, which materially impacts installers' and partners' willingness to do business with them. Although the company has deep pockets for R&D, the solar technology market can only comprise a miniscule portion of their total revenues and profits due to the scale of their other segments. As a result, we feel that their commitment to solar is highly questionable and that while they may be able to gain significant share in the China market, they do not pose a threat on a global basis.

Decision: NO PURCHASE

Natural Resources Investment Committee Representative: Bruce Li

The Natural Resources Sector pitched SEDG on Wednesday, November 28, 2018 in General Meeting as a BUY. The Investment Committee (ICOMM) decided to not purchase SEDG. Our reasons are as follows:

FIRST: We believe that Huawei presents a significant risk to SEDG's market position in the foreseeable future. We note that Huawei is one of the world's largest spenders on research and development, dedicating approximately 15% of annual revenue ($15-$20bn) to new technologies. While Huawei has multiple business lines and is pursuing many markets, we remain concerned about Huawei's potential to rapidly close the technological difference with superior cash firepower and engineering headcount. Huawei is dominant in the utility inverter space, and we believe it will be able to leverage existing relationships, supply chains, and technology to aid its entrance into the residential market. In addition, we observe that Huawei already has products on the market that directly compete with SolarEdge, such as their FusionHome Smart Energy solution for residential solar power (prominently launched in 2018) and their FusionSolar Smart PV solution for commercial and utility solar power. While their products face consumer criticism for poor construction and missing features, we anticipate Huawei easily being able to remedy these problems in future versions.

SECOND: We are concerned with the valuation presented by the sector, which differs materially from market consensus. Specifically, the sector has projected gross margin expansion to 37% by 2020, and 42% by 2024. Equity research across a broad spectrum of firms put gross margin estimates closer to 34% by 2020. When we apply sell-side analyst projections to the sector's model, we arrive at SEDG's current market value. Furthermore, we find that management's projections of gross margins are 6 percentage points lower than the sector model's projections. We again arrive at fair value when we apply management margin projections to the model. To reach meaningful upside with these margin assumptions, we would have to factor in greater than 15% revenue growth, which implies additional gain in market share. We believe that additional market share gain is difficult since high-growth markets, like China or India, have both intense competition and weaker intellectual property enforcement than in the United States or Europe. Given that SolarEdge is a technological leader and has previously faced intellectual property theft, forays into these new markets may prove challenging.

THIRD: While SEDG's technology remains best in-class today, we are aware of newer materials and technologies that SEDG has not nor intends to focus on. Materials like silicon carbide (incorporated in GE's LV5+ inverter technology) and gallium nitride are currently expensive but offer superior performance, such as being able to operate at higher temperatures or to operate at higher switching frequencies. As a result, these new materials are more efficient, which is critical in solar energy production. While management contends that their HD-Wave offering is competitive along the same lines (operating at a higher frequency and more efficiently), we are cautious about management's blanket dismissal regarding these new materials, which may become more affordable as additional research is conducted on them.

Cheniere Energy, Inc. (NYSE: LNG)

Special Situations Sector Leader: Lance Hao

Company Overview

Cheniere Energy, Inc. is the only large, specialized liquefied natural gas producer in America, operating the Sabine Pass and Corpus Christie liquefaction terminals. The core business revolves purchasing cheaper priced domestic natural gas and converting it into liquefied natural gas (LNG), which is then sold off to foreign purchasers. Pricing is set by long-term, low-risk contracts that take advantage of the large spread between gas prices abroad and domestically. Recently, LNG has acquired its subsidiaries in order to consolidate enterprises, but is facing pressure from high near-term capital development requirements in addition to the ongoing trade war with China.

Investment Thesis

The Special Situations Sector recommends a BUY in Cheniere Energy for the following reasons:

1. Attractive Contract Structure: Cheniere Energy enjoys extremely long-term contracts that carry many benefits. First, contract lengths range from twenty to thirty years and therefore allow for more consistently stable cash flows and simpler projections. Second, contracts are comprised of a fixed portion and a variable portion. The variable contract revenue is based on the Henry Hub price (115% premium) and thus hedges against the risk of changes in LNG prices. Adding to this, the fixed fee portion must be paid out even if the customer decides to cancel the shipment of LNG. Third, we believe that since the contracts cover only general volume specifications – rather than design specifications – there is a lower risk of termination.

2. Limited Downside from Domestic Oversupply: We believe that there is low risk of the macroeconomic climate shifting for the worse. Due to the historic progress made in shale production, the volatility of natural gas prices has dropped drastically and oil no longer represents a reasonable benchmark for gas pricing. While oil markets have been undersupplied since 2015, domestic gas markets are oversupplied due to the ease of shale gas production. In the U.S., natural gas supply is projected to continue to outpace demand, which is more stable than oil demand, and therefore preserve low domestic natural gas prices. Currently, natural gas prices abroad are almost 3x those in the U.S., and for the foreseeable future, no other country will be able to ramp up production as fast as the United States, due to certain idiosyncratic geographical factors.

3. Increasing Foreign Demand: We believe that not only will domestic prices remain low, foreign demand will drive natural gas prices and sustain the need for LNG exports. Global LNG imports are estimated to grow at a 12.7% CAGR through 2025, with much of the production coming from the United States. Recent environmental policies (Paris Climate Agreement & Chinese long-term energy goals) call for the transition from coal-generated energy to cleaner natural gas energy and account for a large amount of the future LNG demand. With weak supply in most foreign countries and a low prospect of Qatar/Australia production increases, we believe the U.S. is in a unique position to capture the expanding LNG market.

4. Profitable Reinvestment Opportunities: On a per train basis, the cost revenue structure of each train roughly provides a 19% IRR over the course of just a single average length contract. This rate of return is derived from conservative assumptions: EPC cost of $3B, annual production volume of 4.4mtpa, production cost premium of 120%, with construction taking ~5 years and funded entirely by ~6% senior notes and an average maturity of 10 years. Even decreasing leverage to 50% or increasing EPC costs to $3.5B, we still arrive at a 15% and 13% IRR respectively.

Key Risks and Considerations

1. Loss of Market Share: As new U.S. players enter the LNG industry, market share is projected to decrease from ~75% to ~50% over the next five years. This would potentially devalue contract terms as well as decrease the availability of transportation. Over the long term, this may depress global natural gas prices.

2. LNG Oversupplied: There is general concern that LNG may become oversupplied as the industry becomes crowded with additional players. The large increase in LNG demand over recent years may lead to a tapering off period as energy demand is satiated.

Decision: NO PURCHASE

Special Situations Investment Committee Representative: Anlei Tang

The Special Situations Sector pitched Cheniere Energy, Inc (hereby known as "Cheniere") on Wednesday, November 28, 2018 in General Meeting as a BUY. The Investment Committee (ICOMM) decided to not purchase Cheniere Energy. Our reasons are as follows:

FIRST: We are skeptical that the current favorable contract structure that Cheniere receives will continue past the next 5 years. Both small and large competitors are building sizable liquified natural gas (LNG) terminals scheduled to come online within the next 5 years. New entrants into LNG include both pure play competitors such as Tellurian and NextDecade and entrenched players in the larger energy space such as ExxonMobil. Together, U.S. LNG production is conservatively projected to at least double within the next 5 years. With increased LNG supply into international markets, input costs will certainly rise and the international price of LNG will fall. Given that LNG is a commodity product, we have little confidence that Cheniere Energy's first mover advantage will lead to a sustainable advantage in the long run.

SECOND: The threat from substitutes from dry natural gas produced abroad remains high. Countries such as Russia and China have made forays into building out dry natural gas pipeline networks throughout Europe and Asia. Currently, the price of Russian natural gas sits around the range of $4.50-5.00 per mmbtu compared to U.S. LNG ($7.00 per mmbtu). Given that dry natural gas is the economically superior product, it will be harder for LNG to compete as dry natural gas pipeline networks come online. Because of both increasing domestic and international competitive pressures, we do not believe that new contract terms past the next 5 years will be as attractive as the terms are now (LNG priced at a 115% premium to Henry Hub and 20-year revenue lock in). Since a large percentage of Cheniere's value is derived from cash flows past the projection period (~98% in the bull case), a negative change in cash flows from contracts in the future will be particularly harmful for the valuation.

THIRD: We do not see a large margin of safety with the investment at the current price. With current levels of leverage, even a 0.5% change in the WACC will result in a ~10% change in the value for Cheniere. A small increase in their cost of debt in their next round of financing will erase any implied upside with the valuation. Given the cyclical nature of the natural gas industry, we are not comfortable with this leverage. Additionally, we find the sector's revenue assumptions to be too aggressive. The utilization rate for these trains was projected out to be 4.5 mtpa, or 100% of capacity which allows for no maintenance time or offline time. The high sensitivity of the valuation to production assumptions (a 3% drop in utilization to 4.4 mtpa leads to a target price that is 6% lower than the originally projected price) further increases the risk of this investment.

Exited Positions

Sold Hi-Crush Partners (NYSE: HCLP) for $6.48

Bought at $10.12 (22.8% total loss; -24.5% CAGR)

We invested in HCLP in November 2017, highlighting the company's first mover advantage in the Permian Basin for frac sand production. We believed that as the industry rebounded from cyclical lows, HCLP's status as the first major producer would allow it to capture significant upside and barriers to entry stemming from regulatory constraints, quality standards, and HCLP's industry-leading logistics network would ward off new entrants. However, in the intervening months, industry developments have challenged our beliefs about the strength of these barriers to entry. Supply increases are outpacing demand increases, and the company has been forced to idle production facilities – moving forward, we are concerned that more than half of HCLP's production is at risk of becoming uneconomical. Given our uncertainty over future growth prospects and a vastly different industry prognosis, we no longer find the valuation attractive and have sold off our investment. However, due to the relatively small position (initiated at 2%) we had in HCLP, the absolute loss incurred is minor.

Sold Arcosa (NYSE: ACA) for $28.87

Received through spin-off at $28.63

We received shares of Arcosa through a spinoff of several low-margin segments from Trinity Industries (NYSE: TRN) in a 1-for-3 distribution. Our initial investment thesis in TRN anticipated the spinoff and recommended selling our shares of the poorer quality ACA businesses, which we followed. In the 7 days that we held the stock, we received a small incidental return of approximately 1%. Since we cannot accurately assess what portion of our initial investment into TRN was actually into ACA, it does not make sense to view the return from TRN and ACA separately. The total return from this investment should be evaluated as the total value of our TRN and ACA investments over our initial investment into pre-spinoff TRN, whenever our TRN shares are eventually sold.

Portfolio Weightings