THE NELSON EXCLUSIVE

Confidential*

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KRIS ROSEMANN

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About Your Editor

Brian Nelson is the president of equity research and ETF analysis at Valuentum Securities.

He is the architect behind the company's research methodology and processes, developing the Valuentum Buying Index rating system, the Economic Castle rating, and the Dividend Cushion ratio. Mr. Nelson has acted as editor-in-chief of the firm's Best Ideas Newsletter and Dividend Growth Newsletter since their inception.

Before founding Valuentum Securities in early 2011, Brian worked as a director at Morningstar, where he was primarily responsible for training and methodology development within the firm's equity and credit research department. Prior to that position, he served as a senior industrials securities analyst covering aerospace, airlines, construction, and environmental services companies.

Before joining Morningstar, Mr. Nelson worked for a small capitalization fund covering a variety of sectors for an aggressive growth investment management firm in Chicago. He holds a Bachelor's degree in finance and a minor in mathematics, magna cum laude, from Benedictine University. Brian has an MBA from the University of Chicago Booth School of Business and also holds the Chartered Financial Analyst (CFA) designation.

Highlights:

Brian is frequently quoted in the media and has been a frequent guest on Nightly Business Report, Bloomberg TV, CNBC, and the MoneyShow.

Mr. Nelson is very experienced valuing equities, developing discounted cash-flow models used to derive the fair value estimates for companies in the equity coverage universes of two independent investment research firms, including Valuentum.

Brian worked on a small cap fund and a micro-cap fund that were ranked within the top 10th percentile and top 1st percentile within the Small Cap Lipper Growth Universe, respectively, in 2005.

Mr. Nelson led the charge in developing Morningstar's issuer credit ratings, creating and rolling-out one of the firm's proprietary credit metrics, the Cash Flow Cushion.

Updating Our Thoughts on Income Ideas

A version of this note was sent to members August 30

Dear Nelson Exclusive member:

I hope you may be enjoying the waning days of summer, and for our friends in Houston, Florida, and the Caribbean our hearts and prayers go out to all of those impacted by Hurricanes Harvey and Irma. We wish you a speedy and safe recovery.

Recently, there has been significant market interest in July income idea Vectren (VVC), and we "closed" the position at $65.58 August 30 to take advantage of the pricing advance (see updated tables in this document for more information). The results of the utility's gas infrastructure programs in both Indiana and Ohio remain "on track," and its non-utility performance has also been good. Shares have been rocketing higher recently, however, on news that the utility is working with a financial adviser after experiencing takeover interest. The utility is exploring a variety of options, including a potential sale, and we think it makes sense to capitalize on such market interest, as there remains a distinct possibility the company could still remain independent and the recent price advance could evaporate. The ~13% "gain" in shares since the July edition of the Nelson Exclusive amounts to more than four years' worth of income at its current 2.5% yield. This is just too hard to pass up in a market that remains quite vulnerable, in our view.

I know that many of you have been following the income ideas previously highlighted in the Nelson Exclusive very closely. Our very first income idea, tobacco leaf giant Universal Corp (UVV), has been a big winner, and our conservative nature helped us notify members when we thought shares had effectively run their course--when they jumped to the mid-$70s. What an idea that was. B&G Foods (BGS) hasn't performed nearly as well, and we were blindsided by what appears to be a confluence of factors, from the market apparently giving up on this consumer-staple, despite assigning frothy prices to its peers, to Amazon's (AMZN) entrance into the grocery space, which may not help much with margins. As with the timing of when to consider "taking profits" in Universal Corp, we said we no longer had the stomach to keep watching B&G Foods' stock price fall when it was in the mid-$30s, more than 10% ago.

Income ideas Maxim Integrated (MXIM), Douglas Dynamics (PLOW), and Ennis (EBF) have been nice winners, and our timely "close" of Watsco (WSO) helped to preserve that "gain," too. Star Gas Partners (SGU) has come roaring back, and units of this master limited partnership are now exchanging hands at $10.75. Though with distributions paid thus far the company is trading roughly at cost of highlight, we are mighty pleased to see what was once a very-rare losing position in the Nelson Exclusive publication turn the corner. Moelis & Co (MC) is still holding onto its "gains," though we closed that idea in late July, and while Park National's (PRK) shares have been under pressure, they are still holding up technically at the bottom of their uptrend. We're looking for it to find support at current levels. American Software (AMSWA) put up a quarter the market liked August 28, and shares have rocketed back to near $11 each. We're happy about this, though we recorded a much more self-imposed punitive "close" price a couple months ago.

A version of this note was sent to members August 30

Income idea Northwest Natural Gas (NWN) has performed quite nicely since it was highlighted in the May edition of the Nelson Exclusive, and National Retail Properties (NNN), the August income idea, is also trading above highlight price. Continuing down the list of Nelson Exclusive ideas, we already noted August 30 that we're closing Vectren Corp (VVC) thanks to a recent stock price surge, and while we had some unfortunate timing with the highlight price of June income idea, Japan Tobacco (JAPAY), overall, we're mighty pleased with the quality of income ideas that we've surfaced thus far (all of them outside our traditional coverage universe), particularly in the context of our capital appreciation and short idea considerations--with both sets of ideas putting up solid "success rates."

It often takes time to build a track record with any new publication, and I believe we're starting to see the results of not only selecting great ideas for consideration, but also the benefits of not taking on too much risk with big winners in highlighting 'close' considerations. As of September 9, the total success rate* of all ideas highlighted in the Nelson Exclusive was ~79% from highlight price to close or 'current' price. This is an incredible rate given that we're also highlighting short idea considerations in an "up-market," and a rate I don't think is matched anywhere else given a level playing field. If you have any questions or comments about your membership to the Nelson Exclusive, please let me know.

Thank you for your continued interest!

Always my very best,

Brian Nelson, CFA
brian@valuentum.com

** The percentage of ideas highlighted in the Nelson Exclusive that have moved in the direction of our thesis (i.e. up for income or capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends.*

Defense Ideas and Mallinckrodt Deliver

A version of this note was sent to members August 18

"As we continue to build up a track record and a fantastic "success rate"* in the Exclusive publication, we are forming the building blocks of a very strong case study with respect to the "luck versus skill" question." -- Brian Nelson, CFA

On August 18, we 'closed' a number of Exclusive ideas:

We closed short idea consideration Mallinchrodt (MNK) at $36.41.

We closed capital appreciation idea Huntington Ingalls (HII) at $206.39.

We closed capital appreciation idea Orbital ATK (OA) at $104.65.

All three ideas closed August 18 were directionally "correct." Regarding the closing of Mallinckrodt (MNK), the timing seemed right, as with any short idea consideration, for example, time works against the idea due to borrowing costs (it had already delivered on expectations). The other two capital appreciation considerations were defense idea considerations, and tensions seemed to cool down considerably with North Korea (at the time); we thought it made sense (at the time) to close them. We still very much like the two defense ideas, however.

A few reminders, of course. Shorting is not for everybody, and can theoretically result in infinite capital losses. Also, as a publisher, we don't provide any buy/hold/sell recommendations or provide any financial advice. Please always be sure to contact your personal financial advisor if any investment idea may be right for you. I hope you are enjoying your membership. As we continue to build up a track record and a fantastic "success rate"* in the Exclusive publication, we are forming the building blocks of a very strong case study with respect to the "luck versus skill" question.

For one, "random walk" theory might put our success rate at much closer to 50%, but we're running much, much higher than that level, while surfacing short idea considerations within a strong bull market (one might think our success rate should be below 50% given this and in light of market conditions). We trust you continue to enjoy the Nelson Exclusive publication. I thought it would be one-of-a-kind publication, and I believe it is. We plan to continue to update readers on previous ideas highlighted in future editions, so stay tuned!

Always my very best,

Brian Nelson, CFA
brian@valuentum.com

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Stellar News from Galapagos (GLPG) Clinical Pipeline

By independent contributor Alexander J. Poulos

In the spirit of following up on previously-highlighted ideas (even those that have been closed), we wanted to post a quick update on the clinical news recently released by May 2017 capital appreciation idea Galapagos (GLPG), a promising biotech. Typically in the biotech industry, equity prices will have an exaggerated move upon a positive release of data. The reverse may also happen if the clinical results do not validate the thesis behind the molecule or unexpected side effect torpedo the marketing potential of the product.

Our Initial Attraction to Galapagos

Smaller pre-revenue biotech entities serve a critical function in the drug discovery ecosystem. They often generate funds via the IPO market to support the testing of a promising hypothesis, and if a theory is proven valid, many additional equity raises may be necessary to fund research. An additional way to support the research may be to partner with one of the deep pocketed biotech/pharma companies in exchange for a royalty if the product is brought to market.

We remain impressed with the drug discovery platform at Galapagos (GLPG) with the most promising asset in Filgotinib an oral JAK-1 inhibitor with multiple uses. We continue to feel the JAK-1 class will displace the industry stands for Monoclonal antibodies, which require injections. In addition to the ease of administration, the two more prominent JAK-1's Olumiant and Filgotinib have superior clinical head-to-head results versus the industry standard Humira. We fully expected Olumiant to gain marketing approval in the US in the Spring, but the FDA dashed the hope based on an elevation in platelet levels. The rise of platelets in the Olumiant arm versus the placebo arm of the study has led the FDA to conclude additional clinical trials are warranted. Thus, the commanding marketing lead for Olumiant has evaporated thus leaving an opening for Filgotinib to exploit.

Thus far in clinical trials, Filgotinib has demonstrated a drop in platelet levels, side-stepping the adverse event that plagues Olumiant. A competing product from AbbVie (ABBV) has yet to release full clinical results. Thus, it is not possible at this time to determine which JAK-1 has the greatest potential. Galapagos has partnered with Gilead Sciences (GILD) to co-develop the product, with Gilead taking a significant equity stake in the company. Galapagos has partnered with AbbVie to bring forth a triplet therapy for Cystic Fibrosis which may transform the market from a virtual monopoly controlled by Vertex Pharmaceuticals (VRTX) to a duopoly. Results are still pending, and our excitement remains based on the potential of Filgotinib, the foundation of our bullish thesis.

GLPG1690 for IPF

Idiopathic Pulmonary Fibrosis is a disease with an unknown origin that affects a patient ability to breathe. The disease is progressive-- often the patient will not realize they are affected.

Early signs and symptoms of IPF may include the following:

- *A persistent cough that does not produce any phlegm*
- *Shortness of breath, sometimes even during normal daily activities*
- *A doctor hears "Velcro®-like" crackles deep in the lungs*

Over time, more symptoms may appear or become more severe:

- *You may experience shortness of breath, even at rest*
- *Your dry cough may become more hacking, and you may experience bouts of coughing that you cannot control*
- *You may easily tire, even during light activities*
- *Clubbing (enlargement) of fingers may develop over time*
- *You may require supplemental oxygen therapy due to decreased oxygen saturation of the blood*

Source: knowipfnow.com

The leading product in the market to treat IPF is Genentech's Esbriet which is on track to generate over $800 million in sales for 2017. To displace Esbriet as the market leader, the Galapagos product would likely need to post impressive results, especially if the product can halt the progression of the disease.

It is estimated there are 200,000 patients afflicted with IPF in the US and Europe with an average life expectancy between 2-5 years. The therapy will fall under the guise of an orphan drug category which will accelerate approval times.

GLPG1690 is an autotoxin inhibitor--it operates with a different mechanism than the currently approved treatments. In phase 2 trials, albeit with a small sample size of 23 patients with 17 receiving, the experimental treatment and 6 receiving a placebo (control arm).

The results are awe-inspiring--GLPG not only halted the progression of the disease, it improved Forced vital capacity (FVC) in lungs over the trial period. The treated arm showed an FVC increase of 8 versus an 87 ml decrease in the placebo arm. Based on the impressive results and a side effect profile that was in line with the placebo arm, Galapagos will accelerate the product into phase 3 clinical trials.

Concluding Thoughts

We remain impressed with the potential of Galapagos' drug discovery platform. We feel the company now has two very promising molecules in Filgotinib and GLPG1690 with multi-billion dollar potential. Galapagos is partnered with Gilead for Filgotinib with Gilead amassing a sizeable equity stake in the company.

Galapagos will receive an upfront license fee of $300 million, and Gilead will make a $425 million equity investment in Galapagos by subscribing for shares at a price of €58 per share, which represents a 20% premium as compared to the average share price over the last 30 days. After the issuance of the shares, Gilead will own approximately 15% of the outstanding share capital of Galapagos depending on the $/€ exchange rate at closing. Galapagos is eligible to receive further development, regulatory and commercial milestone payments up to $1.35 billion, plus tiered royalties on global sales starting at 20%, with the exception of the co-promotion territories where profits will be shared equally. -- Source: Galapagos

GLPG1690 is not partnered with an outside firm placing Galapagos in an enviable position. We can easily envision a scenario where Gilead may acquire the remaining portion of the company it currently does not own to shore up its clinical pipeline with two incredible assets. The current market cap of Galapagos is ~ $5 billion, well within the range most pharma/biotechs find to be the sweet spot when conducting M&A. Gilead is precluded from amassing additional shares until the end of December, so a transaction with Gilead may possibly be a 2018 event or later--that is, if it ever comes to fruition. Though we lost our stomach to keep the idea open, we remain bullish on the prospects of Galapagos, irrespective of a takeout or if it remains an independent entity.

Disclosures: Independent healthcare and biotech contributor Alexander J. Poulos is long Gilead Sciences and Galapagos.

Tracking Nelson Exclusive Idea Simulated Performance

As we continue to provide as much transparency as possible in measuring ideas for readers, we'd like to continue to remind you that neither Brian nor Valuentum take any ownership in any stocks highlighted in the Exclusive, and all the trading and information in the tables that follow is simulated. The information provided in the tables is offered for the convenience of the reader, for illustrative purposes only, and no actual trading is taking place. Actual results may differ from the simulated information being presented. Valuentum is a publisher of financial information, not a money manager, broker, or financial advisor.

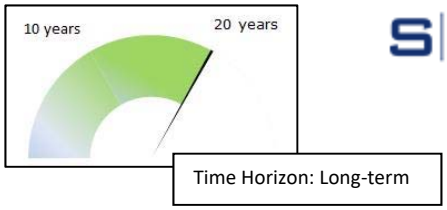
Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Capital Efficiency*	Time Horizon	Notes
Income Ideas								
Jul, 16	Universal Corp (UVV)	57.74	75.10	1.60	32.8%	53.0%	Closed - 2/12/2017	Universal has years of dividend growth ahead of it, but we closed this big winner for the time being. We still like it!
Aug, 16	B&G Foods (BGS)	51.54	35.27	1.815	-28.0%	-27.6%	Closed - 7/17/2017	B&G Foods has taken its share of lumps, the latest coming from Amazon's entrance into the grocery business with the proposed purchase of Whole Foods. We closed the idea.
Sep, 16	Maxim Integrated (MXIM)	41.12	45.07	0.33	10.4%	23.5%	Closed - 2/12/2017	We closed position due to fickle nature of tech. Solid net cash position, strong free cash flow -- ~3% yield. May re-establish idea in future.
Oct, 16	Douglas Dynamics (PLOW)	31.94	34.10	0.235	7.5%	20.4%	Closed - 2/12/2017	We closed as stock had been suspiciously volatile on little news. Insider buying though. We still like it and may re-establish in future.
Nov, 16	Ennis Inc. (EBF)	14.60	16.30	None collected	11.6%	607.1%	Closed -- 11/12/2016	We captured more than 2 years' worth of income via capital appreciation in one week. Not being greedy so this ended in a quick "trade."
Dec, 16	Watsco, Inc. (WSO)	150.57	155.96	1.05	4.3%	22.0%	Closed - 2/12/2017	We closed this idea. Investors have been assessing impact on demand from HVAC price hikes at key customer Carrier (UTX). We still like it, but it is a cyclical industrial.
Jan, 17	Star Gas Partners (SGU)	11.21	10.75	0.323	-	-	0-2 yrs	Star Gas raised its dividend 7%+ in late April. Management noted that second-quarter performance was solid as it looks to cut costs to strengthen long-term outlook.
Feb, 17	Moelis & Co (MC)	35.00	38.10	1.74	13.8%	30.0%	Closed - 7/22/2017	Information reflects special $1 dividend (ex-dividend date, 7/20/17). We continue to like shares of Moelis & Co, but we have closed the idea for now.
Mar, 17	Park National (PRK)	108.59	96.23	1.88	-	-	0-20 yrs	The bank's first half of 2017 is coming in largely as expected, with loans, deposits, assets under management and net income advancing. It recently declared a $0.94/share quarterly dividend.
Apr, 17	American Software (AMSWA)	10.44	10.57	0.11	2.3%	18.6%	Closed - 7/22,23/2017	An email delay caused a notication to be delayed until after material information impacted the stock. As a result, price adjusted from price in email to the low price of the next trading day to reflect conservative, punitive accounting ($12.04 –> $10.57).
May, 17	NW Natural (NWN)	59.20	67.60	0.47	-	-	0-20 yrs	Nice dividend yield. Second-quarter report was strong. Customer growth ensues, and returns have been solid. It reaffirmed 2017 EPS guidance ($2.05 - $2.25/share).
Jun, 17	Japan Tobacco (JAPAY)	19.03	16.90	-	-	-	0-20 yrs	Tobacco stocks have done quite well during this multi-year bull market. Japan Tobacco is an interesting idea, as the industry continues to reinvent itself through 'vaping.'
Jul, 17	Vectren Corp (VVC)	58.21	65.58	None collected	12.7%	85.6%	Closed 8/30/2017	Takeout speculation drove Vectren's price significantly higher, and we closed the position as a result. Recent results show its utility performance is on track, and its non-utility group is performing well.
Aug, 17	National Retail Properties (NNN)	40.50	42.66	-	-	-	0-20 yrs	Second-quarter 2017 results were strong. AFFO per common share increased more than 8% during the period, and the REIT raised its core FFO guidance for 2017 to $2.46-$2.50 (was $2.44-$2.48).

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Capital Efficiency*	Time Horizon	Notes
Capital Appreciation Ideas								
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	22.6%	Closed -- 11/12/2016	We took what the market gave us. We may re-open idea again. We still believe in long term. Stock very cheap.
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	11.9%	Closed - 2/12/2017	We closed this one. Nice streak of consecutive quarterly dividend increases. Very strong end market, and we may re-open in the future.
Sep, 16	Grupo Aeroportuario (ASR)	157.87	181.61	-	15.0%	25.6%	Closed - 4/5/2017	We closed this idea. The strength in the US dollar had hurt. We still love the long-term picture though. Travel to Cancún not going away.
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	284.6SEK	8.5	-	-	0-20 yrs	Tobacco (snus) demand is about as resilient as it gets through the economic cycle. Currency had been hurting shares, but stock could rally back.
Nov, 16	Symrise AG (SYIEY)	16.25	16.34	-	0.6%	1.3%	Closed - 4/5/2017	We closed this idea, but we still like it. EBITDA margins don't get much steadier than Symrise's (18-22% from 2006-2015) though.
Dec, 16	Tootsie Roll (TR)	37.80	38.66	0.18	-	-	0-20 yrs	A fantastic company with excellent financials. Potential big dividend growth story with takeout catalyst as a growing possibility. Stock dividend adjustment (3/3/17) reflected in price.
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	91.6%	Closed - 2/12/2017	Stock grew too extended, so we closed with expectations to re-establish. It's important to gain your trust -- and simulated profits go a long way in doing so.
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	655.3%	Closed - 2/12/2017	We closed this idea. We may re-establish again, but this type of gain in one week is hard not to be prudent with.
Mar, 17	Tesaro (TSRO)	180.84	122.62	-	-32.2%	-94.0%	Closed - 7/7/2017	Very risky biotech. Not for everybody. We highlighted this one to fill an industry void among considerations. We have closed it.
Apr, 17	Yum China (YUMC)	31.15	37.67	-	20.9%	169.8%	Closed - 5/23/2017	The long-term potential of Yum China is amazing. If you haven't read our thesis on shares, please do so. We closed this idea on strong share-price performance, but we may look at it again.
May, 17	Galapagos (GLPG)	87.67	76.13	-	-13.2%	-77.5%	Closed - 7/7/2017	Another very risky biotech. Shares are not for everybody, and principle could be completely wiped out if things go wrong with this consideration. We closed the idea.
Jun, 17	Huntington Ingalls (HII)	193.79	206.39	-	6.5%	31.2%	Closed 8/18/2017	The Navy needs more ships with more advanced capabilities, and Huntington Ingalls is at the center of this need. We closed it, but the company is a compelling idea.
Jul, 17	Orbital ATK (OA)	102.33	104.65	-	2.3%	19.7%	Closed 8/18/2017	The geopolitical environment is becoming more heated, and it seems that tensions with North Korea have only heightened. We closed it, but we like Orbital's position to benefit.
Aug, 17	Wingstop (WING)	32.28	32.90	-	-	-	0-20 yrs	Buffalo Wild Wings' younger cousin may be taking a bite out of its share. We like Wingstop's long-term growth opportunity.

* For this edition and for all future editions of the Nelson Exclusive, we have modified the table headings to better describe the measurement of ideas in the Nelson Exclusive publication. In particular, we are now using the term 'Capital Efficiency' to reflect 'Hypothetical Annualized Closed Gains' as we think of the measure in the column solely as a ranking mechanism, not a measure of any "return" that can be realized.

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Capital Efficiency*	Time Horizon	Notes
Short Idea Considerations								
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	10.7%	Closed -- 12/2/2016	We were worried Eddie Lampert may start buying more heavily. Very volatile equity. Not being greedy, so we closed position.
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	10.8%	Closed -- 12/2/2016	Stock wasn't acting right despite an ongoing negative solar backdrop. We locked gain in as a result.
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	96.1%	Closed -- 11/4/2016	We didn't like Lyolds' leverage and were worried about Brexit. We picked our spot to take profits.
Oct, 16	GoPro (GPRO)	16.68	11.12	NA	33.3%	400.0%	Closed -- 11/4/2016	This was a big winner. We continue to have concerns, and the stock keeps falling. We're not looking back, however.
Nov, 16	Seritage Growth Properties (SRG)	44.31	42.13	-0.25	4.4%	25.6%	Closed -- 1/6/2017	The REIT continues to trade on euphoric expectations, but we closed this for a gain. Dividends work against us as it relates to short performance. Buffett is watching.
Dec, 16	Royal Bank of Scotland (RBS)	4.91	6.50	-	-	-	0-2 yrs	The stock is rallying alongside financials peers. We're watching it closely as Brexit looms. We may extend time horizon.
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	96.6%	Closed 2/12/2017	We locked this short idea in. Retail continues to get pummeled, and we picked the right spot at the right time.
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	492.9%	Closed 2/12/2017	As with Sequential Brands, we picked the right spot at the right time. We locked in this big gain, too.
Mar, 17	Fitbit (FIT)	6.07	5.71	-	5.9%	69.8%	Closed 4/5/2017	Very timely short idea again. We locked this in. The success rate on short idea considerations remains fantastic.
Apr, 17	Santander Consumer (SC)	12.51	11.65	-	6.9%	55.8%	Closed 5/23/2017	Subprime auto may be in for a rough landing. We're expecting continued tough times, but we're going to lock this idea in.
May, 17	Snap, Inc (SNAP)	23.19	17.19	-	25.9%	2360.9%	Closed 5/10/2017	Fantastic timing! Another short idea consideration homerun! See May 10 email: 'Another Exclusive Homerun: Oh SNAP'
Jun, 17	Mallinckrodt (MNK)	42.65	36.41	-	14.6%	70.3%	Closed - 8/18/2017	There's a lot of hair on this one. Famed short seller Jim Chanos doesn't like it. We locked in this winner.
Jul, 17	Deutsche Lufthansa AG (DLAKY)	23.05	26.49	-	-	-	0-20 yrs	We think Ryanair will be a thorn in Deutsche Lufthansa's side in the coming years, and the cyclical nature of the airline industry won't ever go away.
Aug, 17	Del Frisco's (DFRG)	14.35	13.35	-	-	-	0-20 yrs	We think the company's niche will come home to roost once economic growth slows. Technically, shares look vulnerable.
	Average Capital Efficiency* for 'Closed' Positions					**173.5%**	Varies	Performance information is hypothetical and "trading" is simulated. Information provided in table for illustrative purposes only.

The tables above are provided for the sole purpose of transparency, to allow readers to measure Nelson Exclusive ideas in a way they feel is most appropriate. Ideas within the Nelson Exclusive are not constructed as a portfolio, nor should they be viewed as a portfolio, and performance information is hypothetical and "trading" is simulated. "Hypothetical annualized returns," now labeled "Capital Efficiency," cannot be achieved and are provided for the sole purpose of rightsizing each idea to a common measurement period (one year), to compare ideas 'closed' within one year to ones 'open' longer than one year, taking into account capital efficiency. A reader, for example, may view a 20% hypothetical return over a period of five weeks as much better than a 20% hypothetical return over a period of five years. Whereas both represent 20% hypothetical returns, hypothetical annualized performance is much different under each case. Readers may have different views and time horizons. To retain independence, neither Valuentum nor Brian Nelson own any shares, nor do they plan to own any shares, of any companies highlighted in the Nelson Exclusive. Importantly, shorting stocks involves a number of abnormal risks, including theoretically the infinite loss of capital, and is not for everyone. Valuentum is a financial publisher not a financial advisor. Please contact your personal financial advisor to determine if any idea in the Nelson Exclusive may be appropriate for you.



STORE Capital (STOR)

"Our dividend is an important component of our overall stockholder return. And over the past two years, we've increased our dividend per share by 16%, while maintaining a low dividend payout ratio and reducing our leverage. For the second quarter, we declared a cash dividend of $0.29 per common share, representing approximately 66% of our AFFO per share. Our low payout ratio and attractive lease escalators generate excess cash flow that we can invest in new acquisition opportunities to generate strong internal growth." – Cathy Long CFO, STORE Capital 2017 second quarter conference call

Thesis

What's in a name? Shakespeare would have you believe not much; after all, a rose would smell just as sweet if it were called by any other name. However, STORE Capital's (STOR) name is more than an arbitrary moniker; it is a direct description of the REIT's core investment tenets. STORE stands for Single Tenant Operational Real Estate, and it differs from typical commercial real estate in that its investment properties are profit-centers, which are vital to the operations of tenants. This is an important distinction to make as such a necessity for the operation of these real estate developments is necessary for tenants to run a profitable operation, making the leases a higher priority for tenants than other financial obligations. Also, as of the end of the second quarter of 2017, 97% of its leases were triple net leases, meaning the REIT is not responsible for property level costs.

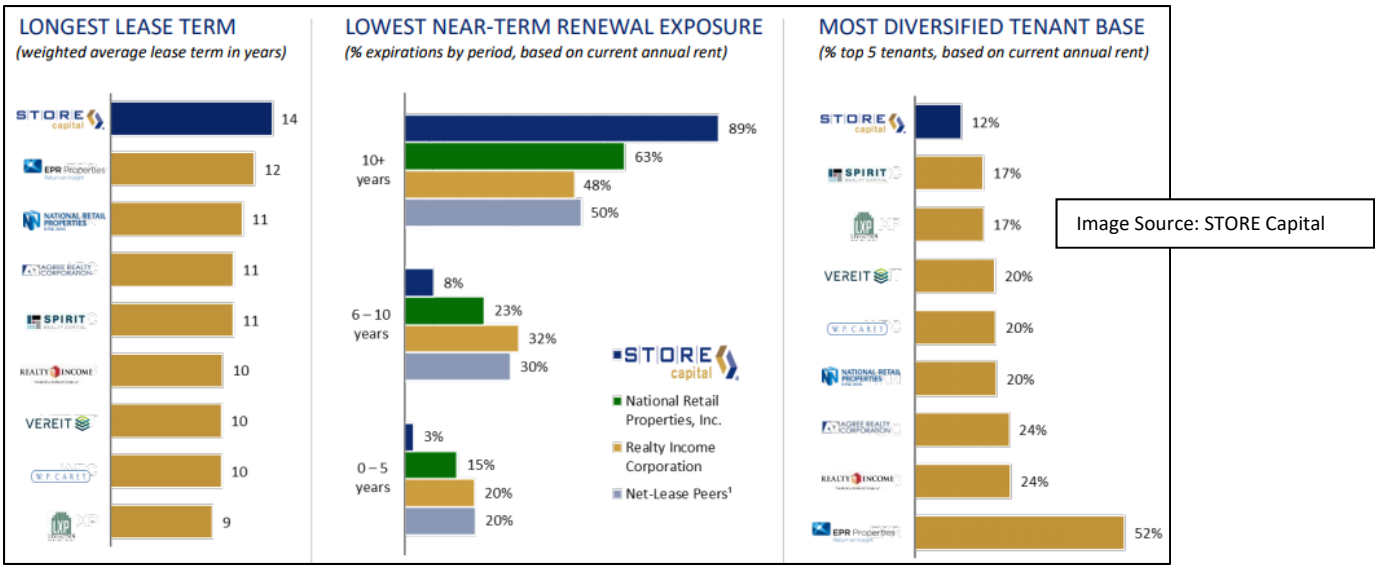
Key Statistics	
Last Close	$25.72
52-week range	$19.65-$30.65
Market Cap	$4.9 B
Avg Daily Vol (30 wks)	1,801,212
Annual Dividend Yield	4.51%
Trailing Dividend Payout Ratio (AFFO)	71%
Trailing P/AFFO	15.7
Credit rating	(BBB-/Baa2)

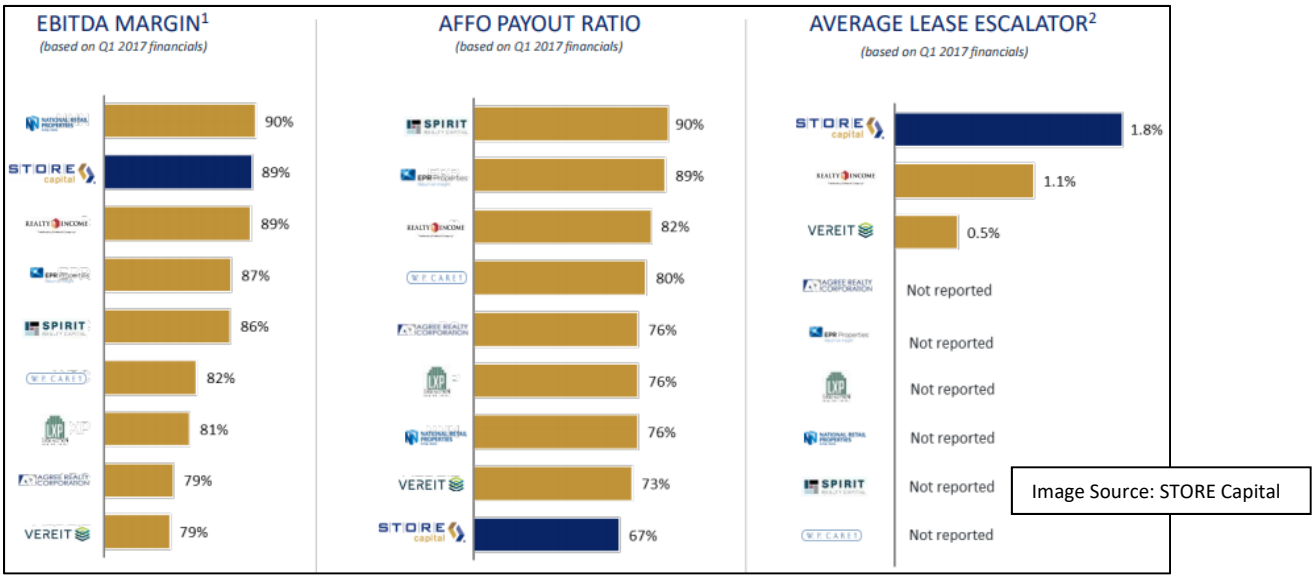
Corporate Profile

STORE Capital is a real estate investment trust that engages in the acquisition, management, and ownership of Single Tenant Operational Real Estate Properties, its target market and inspiration for its name. It is one of the largest and fastest-growing net-lease REITs, and its portfolio consists of investments in 1,770 properties operated by 371 customers as of June 30, 2017.

STORE Capital's name highlights its unique investment strategy, but its strengths go far deeper than that--just ask the Oracle of Omaha, whose Berkshire Hathaway (BRK.B) announced a 9.8% stake in the REIT in late June 2017. In comparison to its retail REIT peers, as of March 31, 2017, STORE boasts the longest weighted average lease term at ~14 years, the lowest near-term renewal exposure, and the most diversified tenant base as measured by the percentage of current annual rent accounted for by top five tenants. STORE also boasts an attractive EBITDA margin that is among the best in its peer group, a very healthy AFFO payout ratio, and an impressive average lease escalator.

STORE's portfolio highlights don't end there. The REIT boasts tremendous occupancy levels of 99.5% as of the end of the second quarter of 2017, and management is quick to point to the Internet-resistant qualities of its portfolio. As of the second quarter of 2017, ~69% of its base rent and interest was accounted for by tenants operating in the service sector. These properties are located near target customers and offer a wide range of





everyday services that are not readily available online. This sector group includes industries such as full and limited service restaurants, early childhood education, movie theaters, and health clubs, among others. Restaurants account for ~21.6% (13.7% from full service and 7.9% from limited service) of base rent and interest, the largest of any industry group.

Image Source: STORE Capital

Customer Industry Groups	# of Properties	Building Sq. Ft. (in thousands)	% Base Rent and Interest[1] As of June 30, 2017	2016
Restaurants – Full Service	342	2,375	13.7%	14.5%
Restaurants – Limited Service	395	1,046	7.9%	9.0%
Early Childhood Education	172	1,889	7.1%	7.6%
Movie Theaters	39	1,873	6.6%	7.2%
Health Clubs	61	1,723	5.6%	6.2%
Family Entertainment	23	822	3.8%	4.0%
Pet Care	95	1,056	2.9%	1.9%
Automotive Repair and Maintenance	85	406	2.7%	2.2%
Career Education	7	584	2.1%	2.4%
Behavioral Health	35	472	1.9%	1.3%
Medical and Dental	28	272	1.5%	0.9%
Elementary and Secondary Schools	7	256	1.5%	1.5%
Equipment Sales and Leasing	17	543	1.5%	1.2%
Lumber Wholesalers	33	1,394	1.4%	0.7%
Wholesale Automobile Auction	6	223	1.2%	0.7%
Consumer Goods Rental	39	537	1.1%	1.0%
All Other Service (22 industry groups)	74	4,272	6.6%	7.7%
Total Service	**1,458**	**19,743**	**69.1%**	**70.0%**

Customer Industry Groups	# of Properties	Building Sq. Ft. (in thousands)	% Base Rent and Interest[1] As of June 30, 2017	2016
Furniture	49	3,096	6.7%	4.0%
Farm and Ranch Supply	22	1,859	3.2%	3.3%
Hunting and Fishing	13	814	1.9%	2.4%
Recreational Vehicle Dealers	8	222	1.1%	1.2%
Home Furnishings	5	691	1.0%	1.3%
Electronics and Appliances	7	331	0.8%	1.0%
Used Car Dealers	11	138	0.6%	0.3%
Grocery	12	524	0.5%	0.7%
All Other Retail (8 industry groups)	33	1,220	1.6%	2.3%
Total Retail	**160**	**8,895**	**17.4%**	**16.5%**
Metal Fabrication	47	4,512	3.5%	3.3%
Plastic and Rubber Products	27	3,299	2.8%	2.3%
Medical and Pharmaceutical	6	431	0.9%	0.8%
Electronics Equipment	5	619	0.8%	0.6%
Paper and Packaging	6	969	0.8%	0.7%
Food Processing	4	396	0.6%	2.2%
Chemical Products	7	631	0.6%	0.4%
All Other Manufacturing (13 industry groups)	50	4,241	3.5%	3.2%
Total Manufacturing	**152**	**15,098**	**13.5%**	**13.5%**
Total Portfolio	**1,770**	**43,736**	**100.0%**	**100.0%**

Tenants in the retail sector account for ~17% of STORE's base rent and interest as of June 30, 2017, and the REIT characterizes its investments in this area as Internet-resistant concepts with a high experiential component. The top three industry groups within STORE's retail sector tenants in terms of percentage of base rent and interest base are furniture, farm and ranch supply, and hunting and fishing (all 4% or less). The manufacturing sector accounts for the balance of base rent and interest, or roughly 14% as of the second quarter of 2017. These properties are primarily located in industrial parks and are strategically positioned near customers. Its manufacturing tenants come from a broad range of industries and generally make everyday necessities, with the top three industry groups in terms of percentage of base rent and interest represented by metal fabrication, plastic and rubber products, and food processing (all 3.3% or less).

STORE Capital owes a large degree of its success to its experienced executive team, and this remains one of its core strengths as its senior leaders have been working together for anywhere between 10 and 35 years. The group has built and managed three net-lease real estate investment companies through the course of multiple economic cycles and interest rate environments, giving it confidence in its ability to handle ongoing economic and geopolitical uncertainty and the potential impacts on its portfolio. Such experience has helped STORE grow its gross asset base to $5.7 billion as of the first quarter of 2017 from just $3 billion at its 2014 IPO. However, this also exposes the REIT to the dangers of depending on specific individuals for a competitive advantage.

STORE's experienced management team keeps its cap structure conservative, and its investment-grade rated credit (BBB-/Baa2) speaks to this dynamic. Moody's and S&P rate its outlook as positive and stable, respectively, and following the recent investment in the REIT from Berkshire Hathaway, STORE lowered its net debt-to-EBITDA target to a range of 5.5x-6.0x. Though management was forced to also lower its AFFO per share guidance for 2017 as a result of the unexpected equity issuance related to the Berkshire investment, it has no plans for further equity issuance in the near term.

A well-laddered debt maturity schedule also helps inspire confidence in STORE's balance sheet. The REIT has no more than ~$317 million in long-term debt maturing in any one year through 2021. To help limit its interest rate sensitivity, management aims to have an annual gap between free cash flow (which it defines as AFFO les dividends) and annual debt maturities of 1.5% or less of the value of its assets.

Image Source: STORE Capital

	Scheduled Principal Payments	Balloon Payments	Total
2017	$ 26,949	$ 9,921	$ 36,870
2018	27,949	6,664	34,613
2019	26,860	213,539	240,399
2020	21,254	296,005	317,259
2021	18,264	229,366	247,630
Thereafter	60,543	1,404,045	1,464,588
	$ 181,819	$ 2,159,540	$ 2,341,359

However, an investment in STORE Capital is not without its fair share of risks. As investment vehicles, REITs are sensitive to interest rates in that yield-hungry investors can likely be expected to move into less-risky asset classes should fixed-income yields return to more historically competitive levels. The current trajectory of rate increases by the Fed remains uncertain, but at this point can perhaps be best described as deliberate.

Several other risks more directly facing the health of STORE Capital's operations and balance sheet exist, including the pressure being felt across the retail space as e-commerce continues to disrupt traditional retail,

negatively impacting traffic levels across the industry. In fact, STORE's fifth largest customer Gander Mountain (less than 2% of base rent and interest) recently filed for Chapter 11 bankruptcy. Regarding its balance sheet and credit rating, risks are present in its high level of secured debt exposure (34% of gross assets as of the first quarter of 2017, a level management is working to reduce), its small percentage of publicly-rated and investment-grade tenants, and its limited history as a public company.

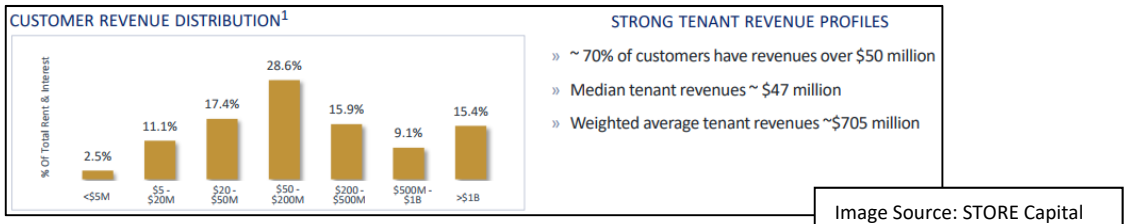


Image Source: STORE Capital

STORE Capital looks to offset its lack of large, investment-grade tenants with investment-grade quality contracts. According to management and its STORE score, which it defines as "a proprietary risk measure reflective of both the credit risk of our tenants and the profitability of the operations at the properties," approximately 75% of its contracts are investment-grade in quality, and its median unit-level fixed charge coverage ratio has hovered near 2.1x in recent years. The REIT continues to target middle market and large companies, and it estimates that its addressable market includes $2.6 trillion in property.

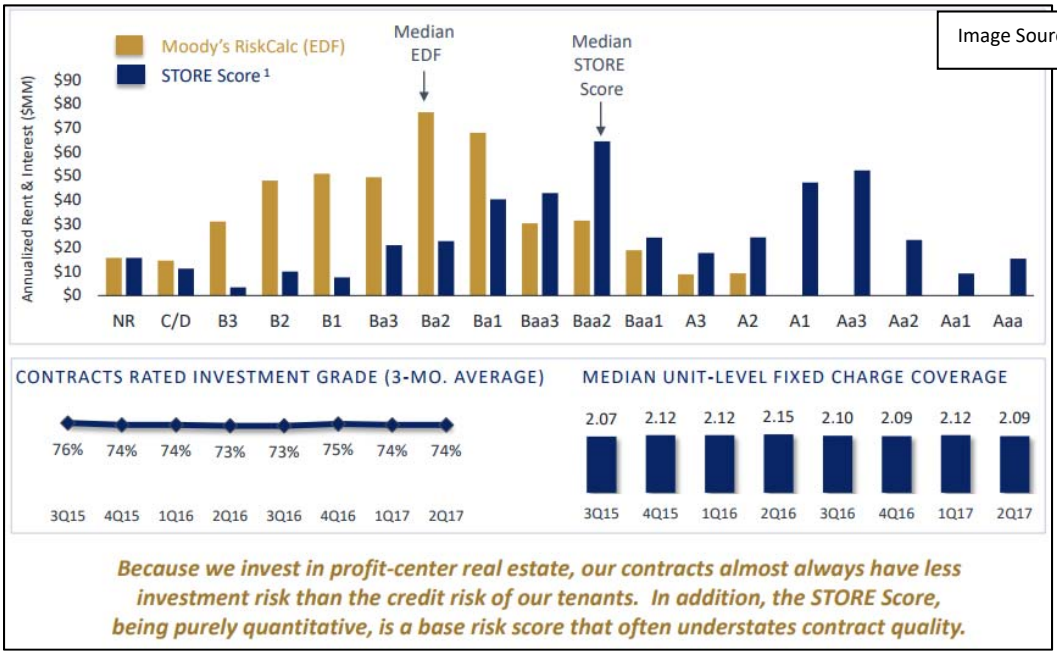
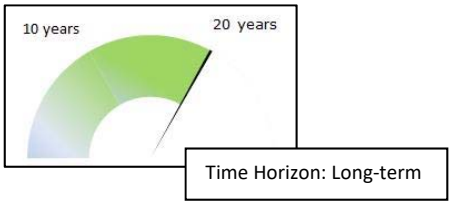


Image Source: STORE Capital

Though its history is limited, STORE Capital has begun developing a reputation for material dividend increases since its 2014 IPO. Dividend hikes of 8% and 7.4% in 2015 and 2016, respectively, are evidence of this, and the company continues to work to enhance its dividend protection via a relatively low payout ratio. A dividend yield of 4.5%+ is extremely difficult to ignore, and we see no reason for the payout not to continue growing for the foreseeable future.

Management's revised AFFO guidance range of $1.59-$1.71 suggests STORE is reasonably priced from a relative value standpoint. Shares are currently trading at ~15.6 times the midpoint of this guidance, compared to an industry average P/FFO of 17.1 times as of July 2017, this according to Lazard Global Real Estate Securities. All things considered, we like STORE Capital's potential to deliver consistent and meaningful income to shareholders. We're taking a long-term approach with this idea.

Kris Rosemann contributed to this article.



Qualys (QLYS)

"…recent attacks like WannaCry and Petya have made it clear that the days of only scanning the network perimeter and a few critical servers are over. Enterprises now require scalability, accuracy and speed in order to identify assets that are vulnerable and ensure they are rapidly and properly remediated, which is 2 something traditional enterprise IT and IT security solutions cannot deliver effectively, ***and at which Qualys excels****." – Qualys Q2 FY2017 Earnings Prepared Remarks*

Thesis

Cybersecurity may be one of the most important and evolving business areas during the past few years. Just last week, for example, one of the largest consumer credit reporting/scoring companies Equifax (EFX) announced a massive cyberattack that may have impacted over 100 million consumers, maybe more! This event follows dozens of other incidents in recent months, where some of the largest organizations have had to deal with the negative consumer backlash from disclosed security breaches. Cybercrime is not going away anytime soon, and services that help protect consumer information within businesses are in high demand.

We think we've found one of the most promising ideas to capitalize on the expected increased spending to prevent cybercrime. Qualys is a relatively-unknown small capitalization idea, but the entity is a pioneer in cloud-based security and compliance solutions. The company capitalizes on the intersection of what we believe to be two very relevant dynamics: 1) the rapid adoption and increased complexity of cloud computing and 2) the need for companies to protect their IT systems and applications from external, unwanted intrusions and cybercrime. Helping its customers achieve compliance with internal rules and external regulations is also a key growth engine for the company. Qualys helps shut out the "bad guys." From its 2016 Form 10-K:

> *We designed our Qualys Cloud Platform to transform the way organizations secure and protect their IT infrastructures and applications. Our cloud platform offers an integrated suite of solutions that automates the lifecycle of asset discovery, security assessments, and compliance management for an organization's IT infrastructure and assets, whether they reside inside the organization, on their network perimeter, on endpoints or in the cloud. Since inception, our solutions have been designed to be delivered through the cloud and to be easily and rapidly deployed on a global scale across a broad range of*

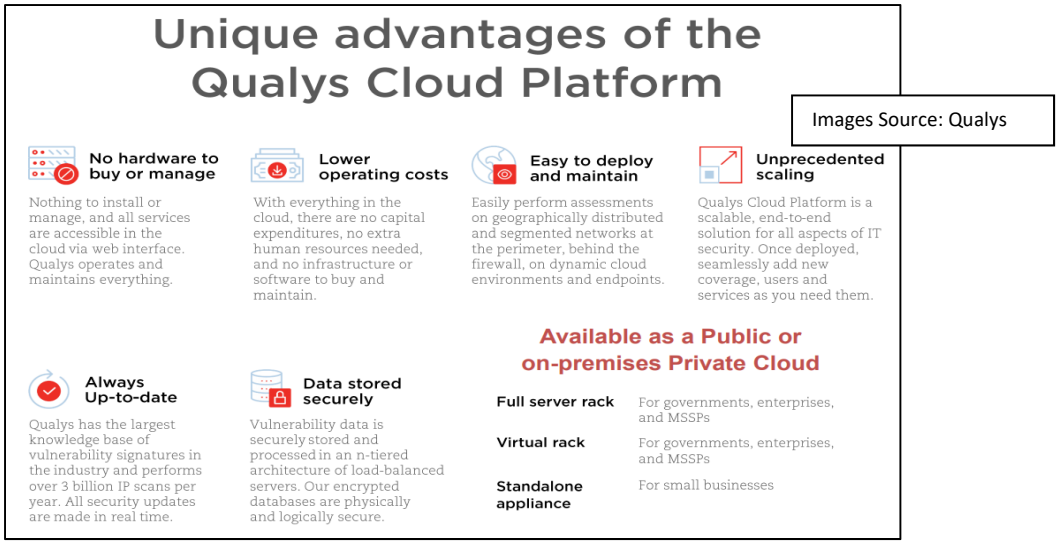
Corporate Profile

Qualys is a key company in the areas of cloud-based security and compliance solutions, helping customers protect their IT systems and applications from cyberattacks and achieve compliance regulations. The entity is a top holding in the Cyber Security ETF (HACK), and its business model may be among the most promising of the group. Its Qualys Vulnerability Management (VM) Solutions account for 75%-80% of annual revenue. The company was founded and incorporated in December 1999. Qualys has ~700 employees.

Key Statistics	
Last Close	$51.10
52-week range	$30.61 - $51.65
Market Cap	$1.9 B
Avg Daily Vol (30 wks)	290,050
Trailing P/E	102.2
Net Cash (LFY)	$244 M

industries, enabling faster implementation and lower total cost of ownership than traditional on-premise enterprise software products. Our customers, ranging from some of the largest global organizations to small businesses, are served from our globally-distributed cloud platform, enabling us to rapidly deliver new solutions, enhancements and security updates (Source: Qualys Form 10-K).

As a leader in Software as a Service (SaaS) security and compliance solutions in the cloud, Qualys is simply in the right spot to capitalize on future demand. The company's cloud platform "delivers 2-second visibility across all global IT assets and (a) continuous view of…security and compliance posture," by consolidating enterprise security functions and compliance applications, all while reducing "infrastructure, operational and maintenance costs" (Investor Presentation, August 2, 2017). Management notes a few advantages to the Qualys Cloud Platform, too – in no particular order: "no hardware to buy or manage, lower operating costs, easy to deploy and maintain, unprecedented scaling, always up-to-date, and data stored securely," per the following image.



If being in the "right" spot with the "right' product weren't not enough, Qualys also has the "right" business model, in our view. The company provides its solutions via renewable annual subscriptions that require customers to pay a fee to use their offering. Qualys' growing addressable market includes a number of recurring revenue growth opportunities, too, and its scalable business model (high sales leverage) works wonders on profit margins, a dynamic that has led it to post industry-leading levels of profitability, significantly better than its peer average and some of its biggest rivals (see image below).

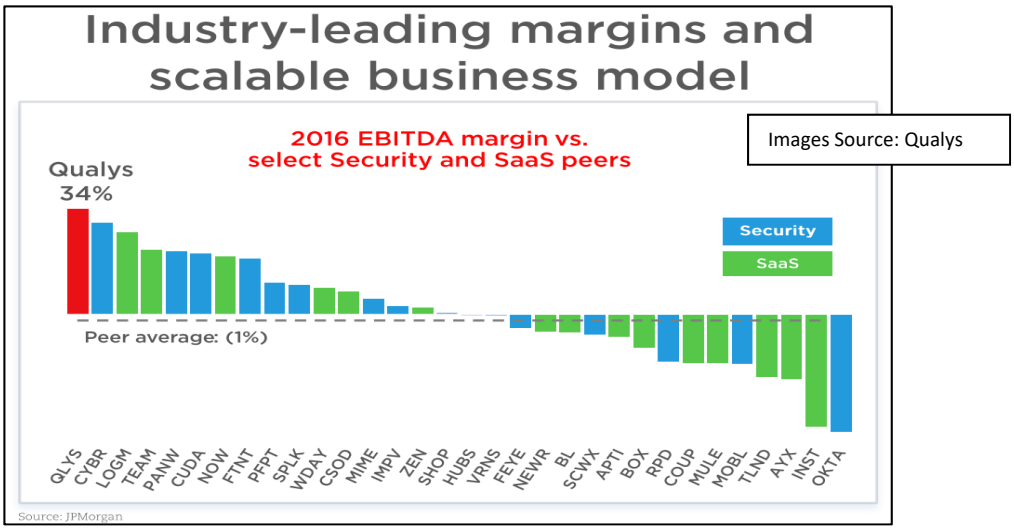
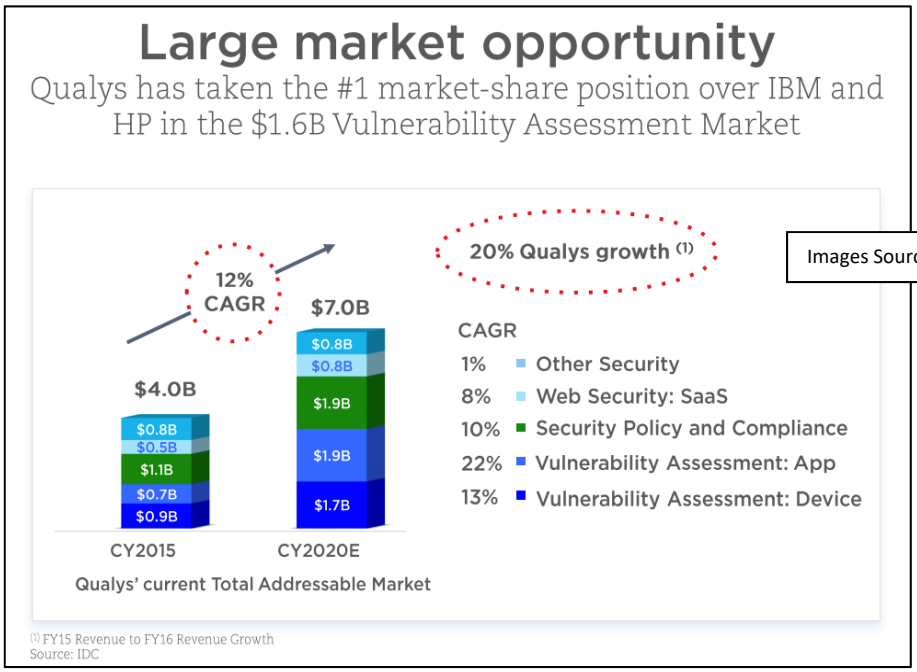


Image Source: Qualys

Qualys' revenue base is well-diversified across some of the largest blue-chip customers, among others (9,300 in total), and no customer accounts for more than 10% of revenue (~70% of clients are US-based). The number of customers with annual contract revenue greater than $500k has increased more than 3-fold since 2014. Qualys continues to experience significant growth from existing customers, too, and it expects this trend to continue. According to information in its recent Form 10-K: "Revenues from customers, existing at or prior to December 31, 2015, grew by $20.4 million to $184.7 million during 2016, representing 112% of total revenues in 2015."

Furthermore, management has noted that it has "taken the #1 market-share position over IBM and HP in the $1.6 billion vulnerability assessment market." The company expects Qualys' total addressable market to advance to $7 billion by calendar-year 2020 from $4 billion in calendar year 2015, estimated at a 12% compound annual growth rate. Qualys' revenue will likely grow at a faster clip though, as it has during the past few years. From 2013-2016, Qualys has revealed a 22% compound annual growth rate in revenue, evidence of potential continued share gains.



Images Source: Qualys

Recent fundamental performance has been great, too. The company raised its 2017 revenue, GAAP earnings per share and non-GAAP earnings per share guidance when it released second-quarter results August 2, 2017. Revenue in the quarter advanced 14%, while gross margin advanced at a similar low-to-mid teens clip, and the company continues to land new customers (Broadcom, Helen of Troy, Pinterest, Spectrum Brands, and Xilinx, among others).

For the full-year 2017, management expects revenue to be $226.8-$228.3 million, or about 17%-18% growth after adjusting for foreign exchange and unusual items. GAAP net income per share is expected in the range of $1.02-$1.06, and while we think this implies a rather hefty multiple on existing earnings, its balance sheet and free cash flow generation are solid. As of the end of the second quarter of 2017, it held $278.9 million in cash and short-term investments and no debt on the books. Qualys is on pace to generate ~$70 million in free cash flow during 2017 (it has hauled in $35.8 million during the first half of the year so far).

Image Source: Qualys

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Net cash provided by operating activities	$ 68,110	$ 65,960	$ 41,423
Less:			
Purchases of property and equipment	(23,245)	(20,051)	(13,914)
Capitalized software development costs	—	(99)	(98)
Free cash flow	$ 44,865	$ 45,810	$ 27,411

Let's now cover the main risks. First, the company's valuation is not as attractive as we would want it to be, but on a fundamental basis, there may be no better company that is tied to cybercrime prevention, a key long-term growth area for long-term capital appreciation potential. Qualys is doing a fantastic job beating out key players IBM and HP, but there are dozens of other entities vying for market share in its target market. Barracuda Networks (CUDA), Imperva (IMPV), Rapid7 (RPD), Symantec (SYMC) are just a few other rivals in the space. We like Qualys' product positioning, but its competitors may have longer operating histories, better name recognition, and better customer relationships.

The biggest risk, in our view, may be a high-profile failure of its product suite that could damage its brand--especially in light of the concentration of revenue coming from subscriptions to its VM Solutions--but we believe continuous innovation is par for the course in the cybersecurity business, and any one event won't likely be tragic. Rapid technological change, short product life cycles, and ongoing changes in customer requirements should only be expected, and Qualys continues to invest tremendously in R&D to enhance its platform (R&D was about 18% of revenue in 2016). Its reliance on third-party channel partners is something worth monitoring, as is the protection of its intellectual property in this fast-changing industry of cybersecurity, while any further executive turnover could pressure the stock. Shares were punished significantly in early 2016 when the company's long-time CFO stepped down.

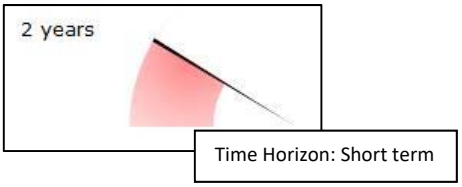
All in, we think there's a lot to like about Qualys, even if its valuation may be a bit on the high end of what we'd prefer. Though there has been some executive turnover of late (CFO Don McCauley stepped down in March of last year, replaced by Melissa Fisher), we generally like that ~20% of outstanding stock is held by executive offices and directors, meaningfully aligning their interests to shareholders. Qualys may be a hidden gem within the cybersecurity end market, but we also have to emphasize that broader market conditions will always be a factor when it comes to long-term returns, especially considering the context of today's frothy equity markets. Qualys' future may be the brightest of any in its industry sub-segment, and the company's attractiveness as a buyout candidate may be icing on the cake (IBM and HP have to be taking notice). The company's shares look poised to break out technically, too.

Image Source: Qualys

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 197,925	$ 164,284	$ 133,579	$ 107,962	$ 91,420
Cost of revenues [1]	42,473	33,885	28,963	24,660	18,404
Gross profit	155,452	130,399	104,616	83,302	73,016
Operating expenses:					
Research and development [1]	35,267	29,451	26,320	21,678	20,195
Sales and marketing [1]	57,970	49,569	48,049	42,523	37,738
General and administrative [1]	32,108	26,573	21,000	16,792	12,079
Total operating expenses	125,345	105,593	95,369	80,993	70,012
Income from operations	30,107	24,806	9,247	2,309	3,004
Other income (expense), net:					
Interest expense	(26)	(6)	(9)	(43)	(192)
Interest income	1,320	570	452	375	14
Other expense, net	(972)	(850)	(1,077)	(600)	(247)
Total other income (expense), net	322	(286)	(634)	(268)	(425)
Income before income taxes	30,429	24,520	8,613	2,041	2,579
Provision for (benefit from) income taxes [3]	11,205	8,655	(21,631)	500	358
Net income	$ 19,224	$ 15,865	$ 30,244	$ 1,541	$ 2,221
Net income attributable to common stockholders	$ 19,224	$ 15,865	$ 30,244	$ 1,539	$ 1,049
Net income per share attributable to common stockholders: [2]					
Basic	$ 0.55	$ 0.47	$ 0.92	$ 0.05	$ 0.09
Diluted	$ 0.50	$ 0.42	$ 0.81	$ 0.04	$ 0.08
Weighted-average shares used in computing net income per share attributable to common stockholders: [2]					
Basic	35,247	34,050	32,979	31,914	11,891
Diluted	38,369	38,184	37,170	35,973	28,352

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percentage Beneficially Owned
Named Executive Officers:		
Philippe F. Courtot (1)	6,452,885	16.9%
Amer S. Deeba (2)	282,243	*
Melissa B. Fisher (3)	26,319	*
Bruce K. Posey (4)	138,066	*
Sumedh S. Thakar (5)	449,554	1.2%
Donald C. McCauley (6)	160,733	*
Non-Employee Directors:		
Sandra E. Bergeron (7)	204,673	*
Donald R. Dixon (8)	401,921	1.1%
Jeffrey P. Hank (9)	87,173	*
Todd P. Headley (10)	4,714	*
Gen. Peter Pace (11)	100,673	*
Kristi M. Rogers (12)	51,173	*
All directors and current executive officers as a group (11 persons) (13)	8,199,394	20.9%
5% Stockholders:		
BlackRock, Inc. (14)	3,115,407	8.4%

Image Source: Qualys. Philippe Courtot has served as Chairman and CEO since March 2001 and has been a director since January 2000.



Fiesta Restaurant Group (FRGI)

Thesis

We've seen an explosion in fast-casual restaurant concepts in recent years. Though this month's short idea consideration has brands that boast decades-long histories, it is far from shielded from the saturated dynamic of the industry. Fiesta Restaurant Group's (FRGI) two restaurant chains are exposed to some other unique risks as well, not the least of which is geographic concentration and the related complications that come with such concentration.

As of the end of the second quarter of 2017, 168 of the 169 company-owned Taco Cabana restaurants are located in Texas, and 134 of the 153 company-owned Pollo Tropical restaurants are located in Florida. In accordance with its Strategic Renewal Plan announced in the second quarter of 2017, Fiesta Restaurant Group altered its growth strategy, and the impairment charge that came along with this plan was the result of the closure of 30 company owned Pollo Tropical restaurants outside of its core Florida markets (the growth of the Pollo Tropical concept outside of the state of Florida has also been suspended until further notice). Such a strategy only exacerbates the already high-level of geographic concentration.

Corporate Profile

Fiesta Restaurant Group owns, operates, and franchises two fast-casual restaurant brands, Pollo Tropical and Taco Cabana. Pollo Tropical offers a variety of Caribbean inspired food, while Taco Cabana offers Mexican-inspired food. Both brands are positioned within the value-oriented fast-casual segment of the restaurant space. Prior to May 7, 2012, it was indirectly owned by Carrols Restaurant Group.

Key Statistics	
Last Close	$15.90
52-week range	$15.50-$30.65
Market Cap	$427 M
Avg Daily Volume (30 weeks)	466,548
Shares Outstanding	26.84 M
Float	26.03 M
Shares Short	3.02 M
Short Ratio	8.04
Short % of Float	15.7%
Shares short (prior month)	2.75 M

Recent weather events in the US have highlighted the risks of such geographic concentration. Third-party sources estimate that 27% of Fiesta's restaurants are located in the city of Houston, which was recently ravaged by Hurricane Harvey. While the true financial impact cannot be determined at this juncture--and it ultimately takes a back seat to the humanity of the situation--we expect that a material disruption of operations can be expected. Not only can operational disruption in the way of forced closures and vacated patrons be expected from the storm itself and the related flooding, but physical damage to restaurants could cause the disruption to continue being felt well into the fourth quarter of the year.

We fear a similar fate may befall Fiesta's high concentration of Pollo Tropical restaurants in the state of Florida as Hurricane Irma is on track to make landfall this weekend on the Florida peninsula as a Category 4 or 5 hurricane. The brand's 17 franchised locations on the island of Puerto Rico, and its headquarters in Miami, Florida, a city that may very well feel the brunt of the storm's tremendous power, are also at severe risk at this time. However, we must note that weather in inherently unpredictable, and banking on Fiesta's Pollo Tropical restaurants being shuttered for a meaningful period of time as a catalyst for shares may not be the soundest of strategies, but it will have a negative impact (not anticipated just a few months ago).

> *Many of our restaurants are located in regions that may be susceptible to severe weather conditions. As a result, adverse weather conditions in any of these areas could damage these restaurants, and/or result in fewer guest visits to these*

restaurants and otherwise have a material adverse impact on our business. For example, our Florida and certain of our Texas restaurants are susceptible to hurricanes, other severe tropical weather events and flooding, and in the past, a number of our Texas restaurants have been periodically affected by severe winter weather. – Fiesta Restaurant Group 2016 10-K

Importantly, we have our fair share of concerns with Fiesta's operations beyond its geographic concentration and the impending disruption. Its two brands had experienced strong growth in the period from 2012-2015, with both concepts turning in impressive comparable company-owned restaurant sales growth year after year, but the metric has turned south in a material way since then. Comparable sales fell 1.6% and 2.5% for Pollo Tropical and Taco Cabana, respectively, in 2016 from 2015 levels, but top-line performance was even worse in the first half of 2017, when Pollo Tropical's and Taco Cabana's comparable sales fell 12.8% and 7%, respectively, from the comparable period of 2016.

Though GAAP profitability has not historically been an issue for Fiesta, the company's bottom-line performance in the first half of 2017 also left much to be desired. GAAP loss per share came in at $0.64 in the first half of 2017 compared to earnings per share of $0.70 in the comparable period of 2016 as continued pressure on food commodity costs was unable to offset higher labor costs, other restaurant operating costs, and impairment charges related in part to its Strategic Renewal Plan. Further, the company has failed to generate positive free cash flow in any year since 2011. Fiesta's total long-term debt-to-EBITDA ratio of ~0.8x as of the end of 2016 is not concerning, but its inability to generate positive free cash flow will keep its balance sheet health from improving as it is forced to use externally-generated funds to cover certain contractual obligations such as debt obligations, which will amount to nearly $74 million through 2020. Refinancing risk is present, and we continue to speculate that a potentially substantial amount of capital may be necessary in coming weeks to repair hurricane-related damages--outside relief efforts are often focused on individuals rather than business.

Image Source: Fiesta

Contractual Obligations

The following table summarizes our contractual obligations and commitments as of January 1, 2017 (in thousands):

	Payments due by period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1 - 3 Years**	**3 - 5 Years**	**More than 5 Years**
Credit facility debt obligations, including interest [1]	$ 73,545	$ 1,877	$ 71,668	$ —	$ —
Capital lease obligations, including interest [2]	2,973	282	564	587	1,540
Operating lease obligations [3]	545,050	43,026	85,164	78,776	338,084
Lease financing obligations, including interest [4]	2,656	143	290	296	1,927
Purchase obligations [5]	14,340	2,390	4,780	4,780	2,390
Total contractual obligations	$ 638,564	$ 47,718	$ 162,466	$ 84,439	$ 343,941

Fiesta Restaurant Group continues to face pressure from activist investor JCP Investment Management, which holds a 9% stake in Fiesta. JCP sent a scathing letter to Fiesta shareholders in May 2017 claiming the company has significantly underperformed peers, suffered from poor corporate governance practices, and poorly allocated capital, the latter of which it claims to be a driver of its negative free cash flow generation. Fiesta has received takeover offers in the recent past, but as recently as late February 2017, the company suspended efforts to sell itself after reviewing strategic options. Readers must be aware of the potential for takeover speculation to impact shares in a meaningful way. Shares also received a material boost in early August after the company announced updated digital-solution based growth initiatives, which include online ordering, delivery, and improved loyalty and catering programs.

We're not anticipating another takeover offer to materialize for Fiesta, due in part to the recently rejected sale, but this could change. Shares look to have already cooled off following the digital initiatives rollout, and material execution risk remains in this regard. All things considered, we're expecting pressure to persist on Fiesta Restaurant Group's share price after considering its recent operation history and the unique risks it is facing. We're assigning this idea a short-term time horizon of 2 years, with the potential to lock it in closer to the present.

Image Source: Fiesta

(Dollars in thousands, except share and per share data)	Year ended January 1, 2017	January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012
Statement of operations data:					
Revenues:					
Restaurant sales	$ 708,956	$ 684,584	$ 608,540	$ 548,980	$ 507,351
Franchise royalty revenues and fees	2,814	2,808	2,603	2,357	2,375
Total revenues	711,770	687,392	611,143	551,337	509,726
Costs and expenses:					
Cost of sales	214,609	217,328	192,250	176,123	163,514
Restaurant wages and related expenses (including stock-based compensation expense of $142, $156, $71, $2 and $11, respectively)	185,305	174,222	155,140	143,392	136,265
Restaurant rent expense	37,493	33,103	29,645	26,849	21,595
Other restaurant operating expenses	96,457	87,285	78,921	69,021	63,813
Advertising expense	26,800	21,617	19,493	17,138	16,791
General and administrative (including stock-based compensation expense of $3,141, $4,137, $3,426, $2,296 and $2,025, respectively)	56,084	54,521	49,414	48,521	43,870
Depreciation and amortization	36,776	30,575	23,047	20,375	18,278
Pre-opening costs	5,511	4,567	4,061	2,767	1,673
Impairment and other lease charges	25,644	2,382	363	199	7,039
Other (income) expense, net [1]	(128)	(679)	(558)	(554)	(92)
Total operating expenses	684,551	624,921	551,776	503,831	472,746
Income from operations	27,219	62,471	59,367	47,506	36,980
Interest expense	2,171	1,889	2,228	18,043	24,424
Loss on extinguishment of debt [2]	—	—	—	16,411	—
Income before income taxes	25,048	60,582	57,139	13,052	12,556
Provision for income taxes	8,336	22,046	20,963	3,795	4,289
Net income	$ 16,712	$ 38,536	$ 36,176	$ 9,257	$ 8,267

Kris Rosemann contributed to this article.

July 1, 2016

Inaugural Letter to Members

Dear Valued Member,

Welcome! You are one of a very limited number of members that will ever bear witness to the pages that follow.

The launch week of the Nelson Exclusive coincided with news that Britain has voted to leave the European Union. The decision, while sending the European banks tumbling violently, does little to muddy the context setting the background of the inaugural edition of this publication.

Broader stock market valuations are at frothy levels, and interest rates continue to hover near all-time lows. The investment-decision landscape is more complicated today than ever before for all types of investors, from those seeking long-term capital appreciation to those that are targeting certain income goals. Cyclicals today are trading at peak multiples on peak earnings, and even consumer staples equities have reached valuation levels that may be more appropriate for aggressive growth equities, not mature operators. *Said differently, the market has laid down the gauntlet.*

The next few years in the markets may be among the most difficult witnessed since the Great Recession. Even a broader market pullback 20% from current all-time highs wouldn't be abnormal given that the collective market valuation of S&P 500 companies has effectively tripled from the March 2009 panic bottom. The launch of the Nelson Exclusive in such conditions can be considered perilous as broader market performance inevitably will act as ballast to the returns of ideas surfaced. In this spirit, I want to remind you that not all ideas in this publication will be successful, and some that are eventually may encounter tough sledding over extended periods of time. As a swimmer cannot achieve his best time swimming against the current, a stock selector cannot achieve his best performance in a down market. Regardless, the value placed on a steady hand during challenging times is priceless.

Let's first cover what the Exclusive is and then we'll talk about what it is not. As you know, the Valuentum investment coverage universe is vast, and what we're seeking to deliver in this publication is ideas that fall outside its reach. We're breaking down the traditional barriers of equity coverage to identify underfollowed gems across the investing spectrum, delivering in each monthly edition one idea for income investors, one idea for readers seeking long-term capital appreciation, and a bonus idea for those looking for a "short" consideration (1). Underfollowed doesn't mean obscure, however, and the ideas that we're targeting will be investable ones, avoiding thinly-traded instruments and penny stock "traps." We'll clearly define our expected time horizon for each consideration, and where applicable, we'll update our theses in subsequent editions. We'll keep score, tracking performance over time.

Let's talk about what the Exclusive isn't. The Exclusive does not constitute individual investment advice, and the ideas within it are not personal recommendations. Each of you reading should always work with your

personal financial advisor who knows your individual goals and risk tolerances. I do not. Only you and your personal financial advisor know what's best for your life circumstances. The personal financial advising markets and what we do at Valuentum via financial publishing are two different verticals in the same industry, but they are different nonetheless. I just want to be very clear about this because I can never tell you to buy or sell anything at any time, even if this may be what you want. It's not that I don't have conviction in my work – it's the rules of the business.

Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might be 55%, average performance might be 50%, while anything below that mark may constituent a poor showing. Obviously, I'm aiming for a 100% success rate, but I also have to be realistic. The great Joe DiMaggio may have hit safely for 56 consecutive games in the last baseball season before the United States was thrust into World War II, but he "only" hit .357 that year. That season of '41, the great Ted Williams would be the last player to hit .400, meaning that one of the best hitters in baseball…ever…was still called out ~60% of the time.

The greatest investors face a similar paradigm. Stock selection is a process where there will be homeruns and strikeouts. You know me. The Exclusive is not a "get-rich-quick" product, and you should keep a close eye on your wallet if you encounter anyone promising anything of the sort. In the inaugural edition of the Nelson Exclusive, I'm going to take 36 swings – they are going to be hard and through the zone, and I'm not going to pull my shoulder out or take my eye off the ball. Market conditions are expected to be stormy in coming years as "reversion-to-the-mean" dynamics rain down, and a crafty lefthander with great "stuff" may be on the mound, but we're stepping up to the plate and digging in.

Batter up!

Sincerely,

Brian Nelson, CFA
President, Investment Research & Analysis
Valuentum Securities, Inc.
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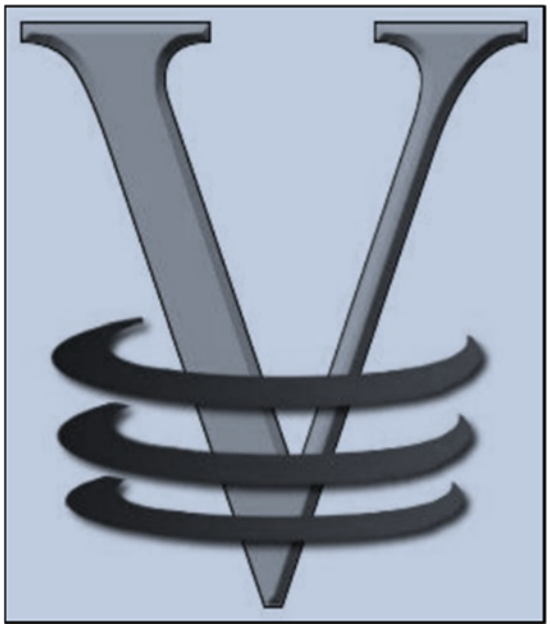

P.S. On a very personal note, I wanted to thank you for your continued support. Without you, neither the Nelson Exclusive publication nor Valuentum would exist. This fact is not lost on me. I thank you deeply.

The Nelson Exclusive: Volume 2, Issue 9

The Nelson Exclusive is published monthly. Contact us at info@valuentum.com for more information.

(1) From the SEC's website: A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market.

Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit. Short selling is also used by market makers and others to provide liquidity in response to unanticipated demand, or to hedge the risk of an economic long position in the same security or in a related security. If the price of the stock rises, short sellers who buy it at the higher price will incur a loss.

Brokerage firms typically lend stock to customers who engage in short sales, using the firm's own inventory, the margin account of another of the firm's customers, or another lender. As with buying stock on margin, short sellers are subject to the margin rules and other fees and charges may apply (including interest on the stock loan). If the borrowed stock pays a dividend, the short seller is responsible for paying the dividend to the person or firm making the loan (Source: SEC https://www.sec.gov/answers/shortsale.htm)

Short selling is not for all types of investors, and readers should consult their personal financial advisor that understands their individual goals and risk tolerances before considering any investment or any strategy. Potential losses for an investor engaging in a short selling strategy are theoretically infinite.

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