THE EXCLUSIVE

Confidential*

April 2019

THE VALUENTUM TEAM

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Exclusive Publication Expectations and Update

A version of this article was sent to members via email March 24.

By Brian Nelson, CFA

I can hardly contain my excitement as to how solid the Exclusive ideas have been. We look forward to continuing to surface excellent ideas for consideration in this publication.

Welcome new members! The Exclusive is generally released on the first Saturday of each month.

Image shown: Invitae (NVTA) was highlighted as a capital-appreciation idea in the September 2018 edition of the Exclusive publication.

The response by members to the Exclusive has been nothing short of incredible, and I thank you greatly for that. The Exclusive is Valuentum's premiere publication in which we highlight an income idea, a capital appreciation idea, and a short-idea consideration each month. These ideas are outside Valuentum's coverage universe, so the Exclusive publication is purely incremental to your existing membership to Valuentum. If you are looking for a constant stream of new ideas each month, this publication is for you.

Thus far, previously-highlighted ideas in the Exclusive publication have done quite well. As it relates to success rates*, capital appreciation and short-idea considerations are running at approximately 80%, and after adjusting for currency, there hasn't been one dividend/distribution cut for an income idea. *This is after 32 editions, or a total of 96 ideas, all presented in full transparency in thesis form.* That is a fantastic track record, and one that follows our strong performance in the Best Ideas Newsletter portfolio and our "call heard round the world" on Kinder Morgan (KMI) and the MLPs. Read more about the call in my book, *Value Trap: Theory of Universal Valuation.*

There are a few things that I want you to be aware of. Each year, we release 36 ideas in this publication, so you shouldn't expect to use each and every one of them. If you may be using this publication in how we think about it, perhaps you might find a dozen or so ideas each year to strongly consider and maybe a handful that you like a lot and fit your goals and risk tolerances. Only your personal financial advisor would know what is right for you. Don't forget about the importance of diversification either. The Exclusive is for idea generation and doesn't lay out a newsletter portfolio, as in the Best Ideas Newsletter or Dividend Growth Newsletter, for example.

When we highlight an idea in the Exclusive publication, we provide a time horizon for the idea to "work out." We've set some time horizons for the long haul, and some other ideas have shorter time horizons. It will depend on each individual idea. Short-idea considerations tend to have shorter time horizons given theoretical borrowing fees, while income ideas may have the longest time horizons given the focus on income generation. In some cases, however, when we've highlighted a long idea, it has shot up rather quickly, but instead of letting what could be large "gains" evaporate, we sometimes close the idea sooner than we might have anticipated (e.g. Wingstop was a double in a couple months). In other cases, as in a short-idea consideration, for example, the idea may moved against us (considerably) for months before eventually working out (e.g. Deutsche Lufthansa).

Each of you will use this publication differently, but we think explaining exactly what kinds of ideas we're highlighting, how we think about the time horizon, and how we've put up the success rates that we have only will give you more information on how to use the publication in a way that may benefit you. When I first started the Exclusive in July 2016, I was as humble as could be and thought we'd run at or slightly above a 50% success rate. At the time, I thought a 60% success rate would be phenomenal. Thus far, the Exclusive publication is running far ahead of that for capital-appreciation ideas and short-idea considerations (~80%). I wrote a note recently about what I thought the value of this publication was to an institution, and I'd peg it at about $20,000/year. I truly believe this. The success rates are simply incredible.

During our first year or so of this publication, we also measured the income ideas in the same fashion as our capital-appreciation ideas, but many of our members suggested that we move away from that process, given the focus on long-term income generation rather than stock-price appreciation. As a result, we now measure our income ideas primarily on the health of their dividend/distribution payments on a go-forward basis. As I highlight in my book *Value Trap: Theory of Universal Valuation*, identifying ideas for income or capital-appreciation are generally two different analytical approaches and therefore, the ideas should be assessed differently, too. We may still close previously-highlighted income ideas should we feel their distribution/dividend is at material risk of reduction.

With that said, **we're excited to announce a few changes to the Exclusive publication** as we welcome a number of new subscribers to the publication and gear up for even more exciting ideas! We'll be crossing the 100 idea mark this year (meaning we've highlighted 100 ideas in this publication since the inaugural edition), and that means we need to simplify some of the tables that we publish at the beginning of each edition. We think it makes sense to remove the "Notes" column in the table as many of the ideas have been closed since their highlight date, but we still plan to provide periodic updates of prior ideas, per request. This is an important part of your subscription, as we comment on ideas that are of interest to you. Let us know what you what us to talk about, and we'll make that happen.

With that said, let's talk about a few ideas that were requested from members recently. Moelis & Co (MC) was an income idea that we highlighted in the February 2017 edition of the Exclusive publication, and the firm's income growth has been nothing short of phenomenal. The company upped its quarterly payout to $0.50 on February 6, the fourth increase in the past three years. Moelis also declared its second special dividend related to 2018 to the tune of $1.25 at that time, payable later this month. Its fourth-quarter

results were solid across the board, with revenue coming in at a record during the period. Shares have faced some pressure since a rather peculiar equity offering in August, but its strong free cash flow generation and debt-free balance sheet remain strong attributes for this dividend payer. Shares yield nearly 4.8% at the time of this writing.

There were a few questions about how high a few previously-highlighted (and subsequently closed) ideas could climb, as it relates to the high end of what could be considered a fair value estimate range. Wix (WIX) was a July 2018 capital-appreciation idea that faced some pressure through the date we closed the idea February 9, but shares have continued to rally, now close to $120 per share. We're not as excited about Wix as we once were, despite locking this one in the "win column." Downside guidance, released February 20, may suggest the company is stretching to meet expectations. We think caution is order at these levels, as shares are bumping up against the high end of our revised fair value estimate range ($75-$125). Our fair value estimate was $110 per share at highlight.

Invitae (NVTA) was our September 2018 capital-appreciation idea. It is a good example of just how quickly some of our long considerations can work out. Shares were highlighted at ~$14 each, and we closed the idea in the March 2019 edition at nearly $21. We said at the time that speculators might see shares continue to move higher, and they certainly have, with the equity almost hitting $26 per share earlier this week. For those that took advantage of Invitae when we highlighted it, it's been almost a double, so please be careful out there. It's a small-cap name, and shares will be extremely volatile; our range of fair value estimate outcomes is equally large (our fair value estimate at highlight was in the high teens). The company is still losing money (it lost $129.4 million in 2018 and $123.4 million in 2017). We have zero appetite for shares at these levels. Don't let a big winner turn into a loser.

Just a reminder, the Exclusive archives are available on a separate website than your regular membership to Valuentum (link below), and the password to retrieve the archives is as follows: **Exclusive*2019**. If we can be of any further assistance at this time, please just let us know.

Thank you!

Kind regards,

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**Success rate: The percentage of ideas highlighted in the Nelson Exclusive that have moved in the direction of our thesis (i.e. up for capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.*

Exclusive Archives: https://nelsonexclusive.wixsite.com/home/newsletter-archive

Closing RH (January Short-Idea Consideration)

A version of this article was sent to members via email April 4.

Image shown: RH has been pummeled after it was highlighted as a short-idea consideration in the Exclusive publication. We're closing it today. We've had some much better short ideas that have paid off even bigger, but it's good to put what looked to be a losing idea in the winner's column!

A version of Brian Nelson's March 28 note to Exclusive members is reproduced below.

Hi Exclusive members,

I'm literally in shock at how well this publication is performing when it comes to idea generation. Maybe I shouldn't be because we work our tails off, but things keep getting better for Exclusive members.

As of the morning of April 4, we've closed RH (RH), our January 2019 short-idea consideration in the Exclusive publication, at $106.99. You can read our January 2019 write-up on RH and its quarterly press release that sent shares tumbling at the links that follow this note.

Given the eroding time value of short-idea considerations, when things work out, we don't wait around for a winner to turn into a loser. We're not looking back. We're looking forward to our next big ideas!

January Exclusive: https://www.valuentum.com/downloads/20190106_1/download

RH fourth quarter press release: https://www.businesswire.com/news/home/20190328005931/en/RH-Reports-Record-Fourth-Quarter-Fiscal-Year

Tracking Exclusive Idea Simulated Performance

INCOME IDEAS

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon
Income Ideas						
Jul, 16	Universal Corp (UVV)	57.74	2.12	3.00	5.2%	Closed - 2/12/2017
Aug, 16	B&G Foods (BGS)	51.54	1.68	1.90	7.9%	Closed - 7/17/2017
Sep, 16	Maxim Integrated (MXIM)	41.12	1.32	1.84	3.2%	Closed - 2/12/2017
Oct, 16	Douglas Dynamics (PLOW)	31.94	0.94	1.09	2.9%	Closed - 2/12/2017
Nov, 16	Ennis Inc. (EBF)	14.60	0.70	0.90	4.3%	Closed -- 11/12/2016
Dec, 16	Watsco, Inc. (WSO)	150.57	4.20	6.40	4.3%	Closed - 2/12/2017
Jan, 17	Star Gas Partners (SGU)	11.21	0.41	0.47	4.9%	0-2 yrs
Feb, 17	Moelis & Co (MC)	35.00	1.28	2.00	4.8%	Closed - 6/22/2017
Mar, 17	Park National (PRK)	108.59	3.76	4.04	4.3%	0-20 yrs
Apr, 17	American Software (AMSWA)	10.44	0.44	0.44	3.4%	Closed - 6/22,23/2017
May, 17	NW Natural (NWN)	59.20	1.88	1.90	2.9%	Closed - 10/25/2018
Jun, 17	Japan Tobacco (JAPAY)	19.03	0.60	0.67	5.5%	0-20 yrs
Jul, 17	Vectren Corp (VVC)	58.21	1.68	Acquired	Acquired	Closed 8/30/2017
Aug, 17	National Retail Properties (NNN)	40.50	1.90	2.00	3.7%	Closed - 10/25/2018
Sep, 17	STORE Capital (STOR)	25.72	1.16	1.32	3.9%	Closed - 10/25/2018
Oct, 17	Fortis (FTS)	36.14	1.27	1.35	3.6%	0-20 yrs

Many members have said that they prefer to focus on the long-term income-oriented dynamics of the income ideas, and we think this makes sense. The formatting of the table reflects a greater focus on the trajectory of the dividend as well as the current forward expected annualized dividend yield. We hope that you find this layout more helpful as you sort through the prior income ideas.

INCOME IDEAS

Highlight Date	Company (symbol)	Highlight Price	Annual Divs per Share at Highlight	Current Fwrd Dividends per Share	Current Fwrd Exp Dividend Yield	Time Horizon
Income Ideas						
Nov, 17	Black Hills (BKH)	61.23	1.78	2.02	2.7%	Closed - 10/25/2018
Dec, 17	Four Corners Propety Trust (FCPT)	26.03	0.97	1.15	3.9%	Closed - 10/25/2018
Jan, 18	TransCanada Corp (TRP)	49.47	1.98	2.24	4.9%	0-20 yrs
Feb, 18	Siemens (SIEGY)	71.13	2.18	2.17	3.8%	0-20 yrs
Mar, 18	Philips 66 Partners (PSXP)	49.63	2.71	3.34	6.3%	Closed - 10/25/2018
Apr, 18	PS Business Parks (PSB)	113.68	3.40	4.20	2.8%	Closed - 10/25/2018
May, 18	Hubbell (HUBB)	103.97	3.08	3.36	2.7%	Closed - 2/11/2019
Jun, 18	Park Hotels & Resorts (PK)	32.43	1.72	1.80	5.6%	0-20 yrs
Jul, 18	Healthcare Trust of America (HTA)	27.36	1.22	1.24	4.3%	Closed - 2/11/2019
Aug, 18	QTS Realty Trust (QTS)	44.01	1.64	1.76	3.8%	0-20 yrs
Sep, 18	Atmos Energy (ATO)	93.62	1.94	2.10	2.1%	Closed - 10/25/2018
Oct, 18	Veolia Environment (VEOEY)	19.70	0.99	1.03	4.5%	0-20 yrs
Nov, 18	Roche Holding (RHHBY)	29.82	1.08	1.09	3.2%	Closed - 2/11/2019
Dec, 18	OGE Energy (OGE)	40.46	1.46	1.46	3.4%	Closed - 2/11/2019
Jan, 19	BAE Systems (BAESY)	24.32	0.92	0.92	3.5%	Closed - 2/11/2019
Feb, 19	EastGroup Properties (EGP)	107.58	2.88	2.88	2.6%	0-20 yrs
Mar, 19	Canadian Natural Resources (CNQ)	26.76	1.01	1.13	3.9%	0-20 yrs

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.

Capital Appreciation Success Rates* ~82%

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Capital Appreciation Ideas						
Jul, 16	Bloomin Brands (BLMN)	17.87	19.28	0.07	8.3%	Closed -- 11/12/2016
Aug, 16	Healthcare Srvs Group (HCSG)	38.91	41.02	0.369	6.4%	Closed - 2/12/2017
Sep, 16	Grupo Aeroportuario (ASR)	157.87	181.61	-	15.0%	Closed - 4/5/2017
Oct, 16	Swedish Match (SWMA.ST)	314.80SEK	417.40SEK	17.7	38.2%	Closed - 6/1/18
Nov, 16	Symrise AG (SYIEY)	16.25	16.34	-	0.6%	Closed - 4/5/2017
Dec, 16	Tootsie Roll (TR)	37.80	38.24	0.90	-	0-20 yrs
Jan, 17	Texas Capital Bancshares (TCBI)	78.05	85.10	-	9.0%	Closed - 2/12/2017
Feb, 17	Arconic (ARNC)	25.90	29.62	-	14.4%	Closed - 2/12/2017
Mar, 17	Tesaro (TSRO)	180.84	122.62	-	-32.2%	Closed - 7/17/2017
Apr, 17	Yum China (YUMC)	31.15	37.67	-	20.9%	Closed - 5/23/2017
May, 17	Galapagos (GLPG)	87.67	76.13	-	-13.2%	Closed - 7/17/2017
Jun, 17	Huntington Ingalls (HII)	193.79	206.39	-	6.5%	Closed 8/18/2017
Jul, 17	Orbital ATK (OA)	102.33	104.65	-	2.3%	Closed 8/18/2017
Aug, 17	Wingstop (WING)	32.28	66.17	3.61	116.2%	Closed - 10/25/2018
Sep, 17	Qualys (QLYS)	51.10	75.44	-	47.6%	Closed - 10/25/2018
Oct, 17	Guidewire Software (GWRE)	78.24	87.50	-	11.8%	Closed - 10/25/2018
Nov, 17	Ferrari N.V. (RACE)	117.43	123.26	0.71	5.6%	Closed - 2/11/2019

CAPITAL APPRECIATION IDEAS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Capital Appreciation Ideas						
Dec, 17	Square (SQ)	38.22	72.61	-	90.0%	Closed - 10/25/2018
Jan, 18	Planet Fitness (PLNT)	33.70	46.41	-	37.7%	Closed - 10/25/2018
Feb, 18	Insulet Corp (PODD)	75.84	82.69	-	9.0%	Closed - 10/25/2018
Mar, 18	Preferred Bank (PFBC)	64.01	47.16	1.02	-	0-20 yrs
Apr, 18	Esperion Therapeutics (ESPR)	66.43	42.96	-	-	0-20 yrs
May, 18	Heidrick & Struggles (HSII)	37.65	40.77	0.41	9.4%	Closed - 3/9/2019
Jun, 18	Green Dot Corp (GDOT)	72.86	61.91	-	-	0-20 yrs
Jul, 18	Wix.com (WIX)	105.30	111.93	-	6.3%	Closed - 2/11/2019
Aug, 18	Tactile Systems Technology (TCMD)	50.84	63.52	-	24.9%	Closed - 10/25/2018
Sep, 18	Invitae (NVTA)	13.95	20.84	-	49.4%	Closed - 3/9/2019
Oct, 18	Cigna (CI)	215.72	166.13	0.04	-	0-20 yrs
Nov, 18	Yeti Holdings (YETI)	16.50	17.99	-	9.0%	Closed - 2/11/2019
Dec, 18	Spotify (SPOT)	135.31	141.13	-	-	0-20 yrs
Jan, 19	Suncor Energy (SU)	29.32	32.05	-	9.3%	Closed - 2/11/2019
Feb, 19	Delek Holdings (DK)	32.12	39.15	0.27	-	0-20 yrs
Mar, 19	Physicians Realty Trust (DOC)	17.82	18.64	0.23	-	0-20 yrs

Success rate: The percentage of ideas highlighted in the Exclusive that have moved in the direction of our thesis (i.e. up capital appreciation ideas and down for short idea considerations) through the current price or closed price, with consideration of cash and stock dividends. Success rates do not consider trading costs or tax implications.

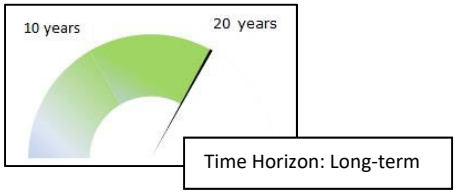
Short Consideration Success Rates* ~79%

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Short Idea Considerations						
Jul, 16	Lands' End (LE)	16.76	16.10	NA	3.9%	Closed -- 12/2/2016
Aug, 16	Vivint Solar (VSLR)	2.94	2.85	NA	3.1%	Closed -- 12/2/2016
Sep, 16	Lloyds Banking (LYG)	3.31	2.78	NA	16.0%	Closed -- 11/4/2016
Oct, 16	GoPro (GPRO)	16.68	11.16	NA	33.1%	Closed -- 11/4/2016
Nov, 16	Seritage Growth Properties (SRG)	44.31	42.13	0.25	4.4%	Closed -- 1/6/2017
Dec, 16	Royal Bank of Scotland (RBS)	4.91	6.66	0.34	-	0-2 yrs
Jan, 17	Sequential Brands Group (SQBG)	4.62	4.18	-	9.5%	Closed - 2/12/2017
Feb, 17	Sportman's Warehouse (SPWH)	6.85	6.11	-	10.8%	Closed - 2/12/2017
Mar, 17	Fitbit (FIT)	6.07	5.71	-	5.9%	Closed - 4/5/2017
Apr, 17	Santander Consumer (SC)	12.51	11.65	-	6.9%	Closed - 5/23/2017
May, 17	Snap, Inc (SNAP)	23.19	17.19	-	25.9%	Closed - 5/10/2017
Jun, 17	Mallinckrodt (MNK)	42.65	36.41	-	14.6%	Closed - 8/18/2017
Jul, 17	Deutsche Lufthansa AG (DLAKY)	23.38	21.42	0.94	4.4%	Closed - 10/25/2018
Aug, 17	Del Frisco's (DFRG)	14.35	11.93	-	16.9%	Closed - 10/16/17
Sep, 17	Fiesta Restaurant Group (FRGI)	15.90	14.36	-	9.7%	Closed - 2/11/2019
Oct, 17	Ingles Markets (IMKTA)	26.50	24.20	-	8.7%	Closed - 10/16/17

The tables above are provided for the sole purpose of transparency, to allow readers to measure Exclusive ideas in a way they feel is most appropriate. Ideas within the 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 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 Exclusive may be appropriate for you.

SHORT IDEA CONSIDERATIONS

Highlight Date	Company (symbol)	Highlight Price	Current or "Close" Price	Div's Received	'Hypothetical' 'Closed'Gain %	Time Horizon
Short Idea Considerations						
Nov, 17	Fogo de Chao (FOGO)	10.85	15.62	-	-44.0%	Closed - 3/3/2018
Dec, 17	TrueCar (TRUE)	12.07	10.97	-	9.1%	Closed - 12/28/17
Jan, 18	Shake Shack (SHAK)	44.17	60.13	-	-	0-2 yrs
Feb, 18	iShares Core US Aggregate Bond ETF (AGG)	107.20	104.63	1.93	0.6%	Closed - 10/25/2018
Mar, 18	iShares iBoxx $ High Yield Corporate Bond ETF (HYG)	85.75	86.43	4.936	-	0-2 yrs
Apr, 18	Houghton Mifflin Harcourt (HMHC)	7.25	6.70	-	7.6%	Closed - 6/1/18
May, 18	Noodles & Company (NDLS)	7.25	7.04	-	2.9%	Closed - 2/11/2019
Jun, 18	iShares International High Yield Bond ETF (HYXU)	52.40	50.94	-	2.8%	Closed - 10/25/2018
Jul, 18	Installed Building Products (IBP)	56.15	40.10	-	28.6%	Closed - 9/28/2018
Aug, 18	Veritiv Corp (VRTV)	38.80	36.35	-	6.3%	Closed - 9/28/2018
Sep, 18	Box (BOX)	24.55	24.30	-	1.0%	Closed - 9/28/2018
Oct, 18	Modine Manufacturing (MOD)	14.73	12.00	-	18.5%	Closed - 10/25/2018
Nov, 18	Beazer Homes USA (BZH)	9.01	12.28	-		0-2 yrs
Dec, 18	Vera Bradley (VRA)	10.22	13.10	-		0-2 yrs
Jan, 19	RH (RH)	117.84	106.99	-	9.2%	Closed - 4/4/2019
Feb, 19	QuinStreet (QNST)	14.77	12.79	-	13.4%	Closed - 3/9/2019
Mar, 19	Dycom Industries (DY)	47.20	50.02	-		0-2 yrs



Evergy Inc (EVRG)

"Closing the merger allowed us to start capturing the benefits for our shareholders, customers and employees for years to come. Our company is now better positioned to operate efficiently and approach the future from a position of strength. We executed our target merger savings over the first seven months of our company. We're able to achieve constructive regulatory outcomes and settle in each of our filed rate reviews which reflects tax reform benefits for all customers. Not an easy task especially following the multi-year merger proceeding." – Terry Bassham, CEO, Evergy fourth quarter 2018 conference call

Thesis

As a combined entity operating under the Evergy (EVRG) umbrella, Great Plains Energy and Wester Energy should yield substantial synergies by consolidating their transmission, distribution, and generation footprints in Kansas and Missouri. Those synergies, primarily represented by reduced operations expenses (i.e. reducing redundant support services), were forecasted to come in at just $30 million in 2018 before rising to $160 million by 2022. A combination of rate base growth (Evergy has $6 billion in capital expenditures planned for 2019–2023), merger-related synergies, its push into renewables, and its ongoing stock buyback program are the driving forces behind Evergy's forecasted earnings per share growth of 5%–7% from estimated 2019 levels through 2023. EPS growth will power dividend growth as Evergy plans to maintain a 60%-0% payout ratio. We like Evergy due to its clear line of sight on both revenue growth and cost control measures, which paints an optimistic outlook going forward.

Corporate Profile

Evergy Inc as it stands today is the product of a 2018 merger of equals between Great Plains Energy and Westar Energy. This midsized electric utility caters to 1.6 million customers in Kansas and Missouri through 14,500 MW of owned electricity generation capacity. Evergy owns the vast majority of the Wolf Creek nuclear power plant. Renewables, particularly wind turbines, are increasingly representing a larger share of its annual electricity generation as older fossil fuel-powered systems are retired. Evergy's operations are supported by 13,700 miles of transmission systems and 52,200 miles of distribution networks. As of this writing, Evergy yields 3.4%.

Key Statistics	
Last Close	$57.32
52-week range	$50.89-$61.10
Market Cap	$14.4 B
Avg Daily Vol (30 wks)	1,836,108
Annual Dividend Yield	3.31%
Trailing Dividend Payout Ratio	76%
Trailing P/E	22.9
Credit rating	A-

Planning for the Future

Evergy is an electric utility company with its eyes firmly set towards the future. Back in 2010, when most green energy developments were still very uneconomical, only 1% of Evergy's generation capacity was represented by renewables. As the 2010s wore on and wind turbines, solar panels, and other types of green energy developments saw their levelized cost of electricity move precipitously lower, Evergy's legacy companies got out ahead of their peers and started investing in renewables (specifically wind turbines). Now the company expects 27% of its generation capacity will be represented by renewables in 2020, while coal's share is forecasted to drop from 52% in 2010 to 40% in 2020.

What makes this shift so important is that Evergy is getting ahead of any potential legal, regulatory, or political action that could increase the cost of fossil fuel-powered electricity generation. The Clean Power Plan, proposed by former President Obama's administration, is a perfect example of one of the big hurdles (or game changers, depending on how one looks at it) facing domestic electric utilities in America. Utilities heavily reliant on coal-powered electricity generation are the most exposed to any future proposal that resembles (or goes farther than) the Clean Power Plan, which has been put on ice pending its potential repeal. Higher operating expenses relative to its greener peers and the possibility those additional costs couldn't easily be passed down to customers could ultimately lead to many fossil fuel power plants closing down (especially coal and oil-powered facilities), putting a huge dent in the ability of the utilities that didn't plan ahead to grow or even sustain their existing dividend payments (due to the loss of electricity generation capacity and the related cash flow). Evergy doesn't want to run that risk, which supports its long-term growth trajectory if this shift is maintained.

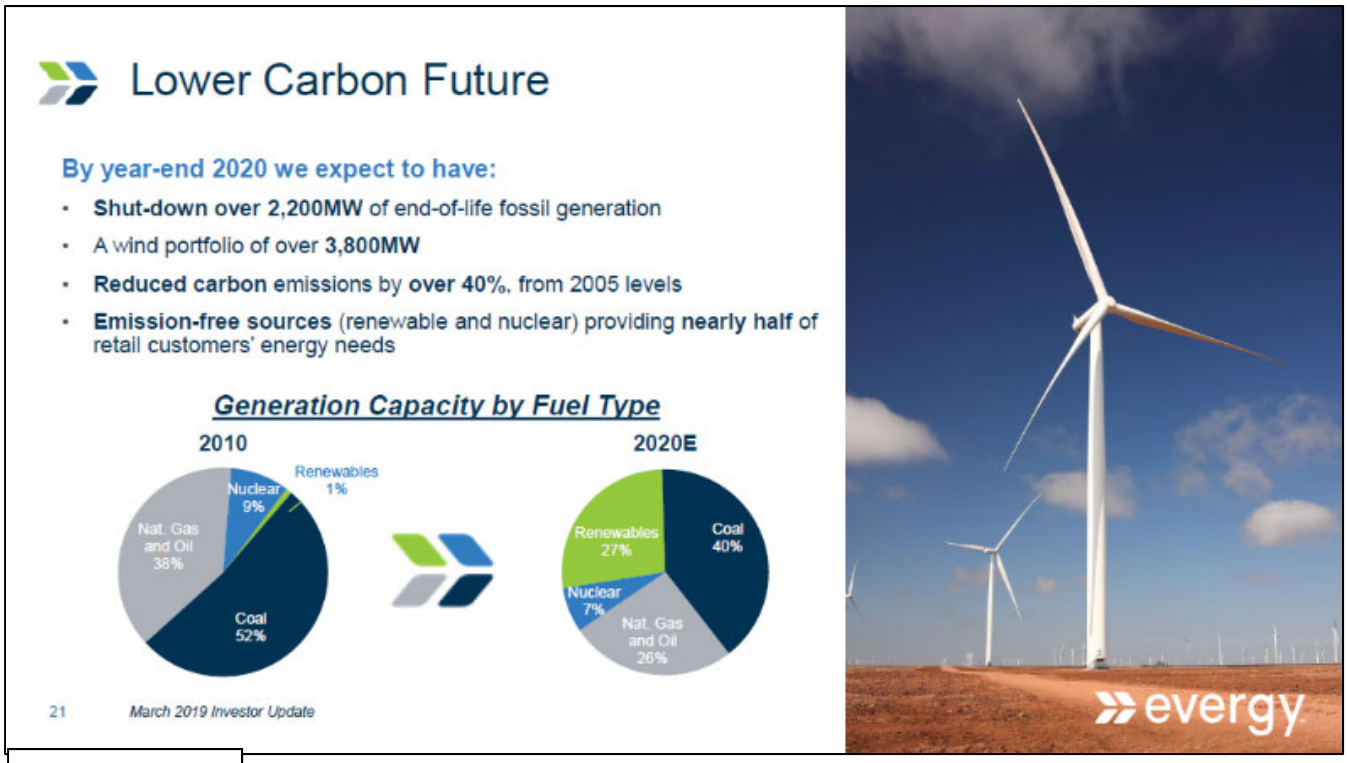


Image Source: Evergy

Evergy still sourced 55% of its electricity generation from coal in 2018, versus 23% from renewable sources and 17% from uranium (due to its stake in the Wolf Creek nuclear power plant). Management is off to a great start as green energy still has a way to go before being truly competitive with most fossil fuels without subsidies being involved.

Utility companies need to be careful when managing their credit profiles as rolling over debt and constantly tapping capital markets represents a core part of their business strategy. Evergy retains strong investment grade credit ratings from both S&P Global and Moody's, which the company plans to lean on to issue out more debt to fund its share repurchase program *"to balance [its] capital structure."* Evergy approved a 60 million share buyback program in July 2018, and as of February 2019, had repurchased roughly 19 million shares. In 2018, Evergy spent over $1.0 billion buying back its stock.

In March 2019, Evergy executed on a $1.0 billion term loan to help cover repurchases. The company also plans to issue $1.5 billion of holding company debt sometime this year to help fund the remaining buybacks, with the goal being to complete this program by the middle of 2020. During Evergy's first quarter of 2019 earnings release, we expect to get a lot more information on those developments.

Reducing its share count will put a tremendous amount of downward pressure on its total dividend payments in the medium-term. During the fourth quarter of 2018, Evergy had 262 million in pro forma outstanding shares, versus 272 million pro forma outstanding shares during the fourth quarter of 2017. For the full-year, Evergy expects its outstanding share count will come in at 240 million in 2019 (plus or minus 2%).

Evergy was sitting on a total debt load of $8.5 billion at the end of 2018, with about $0.7 billion of its long-term maturities coming due this year. Management noted that the company plans to refinance a similar amount of debt this year at the utility level in order to roll that burden over.

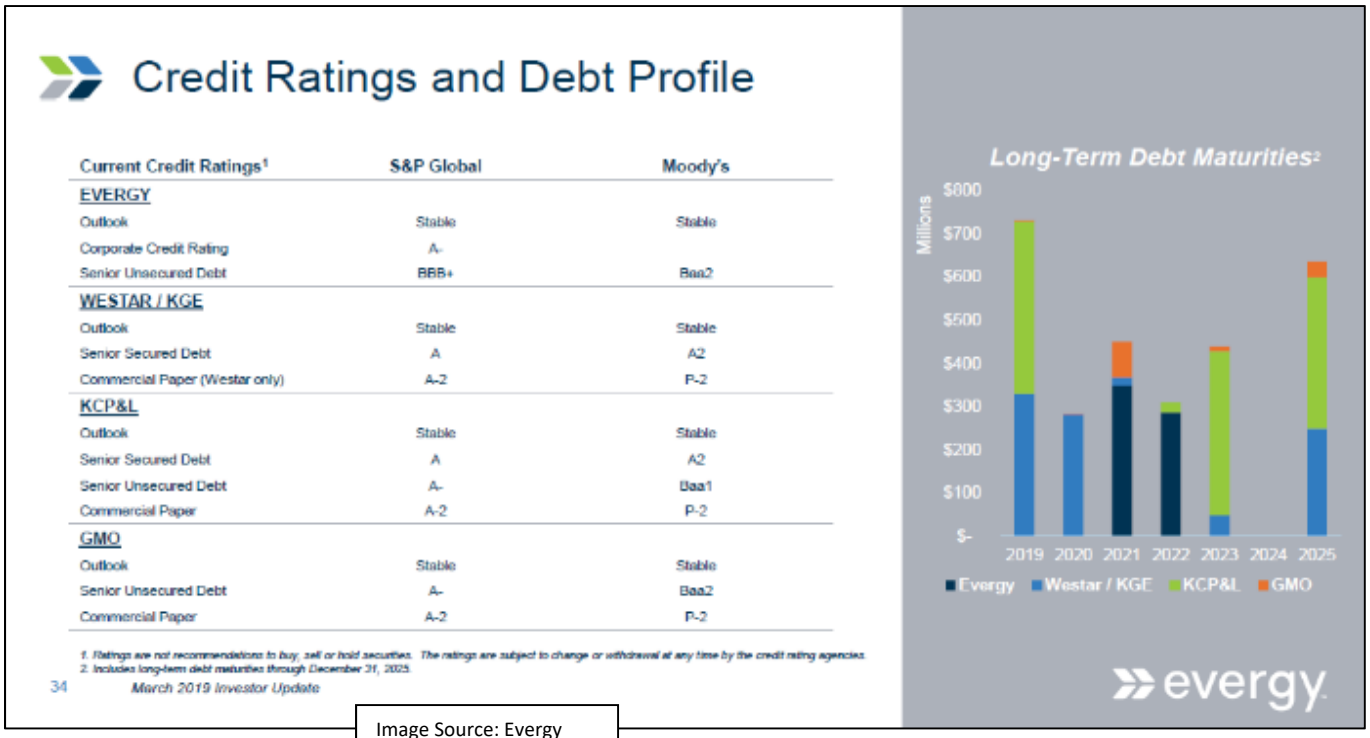


Image Source: Evergy

At the end of last year, Evergy was sitting on a $8.4 billion net debt position. The company generated $1.55 billion in EBITDA that year, good for a net debt to EBITDA ratio of 5.4x. In 2017, Evergy's net debt load came in at $4.1 billion while the company generated $1.05 billion in EBITDA, good for a net debt-to-EBITDA ratio of 3.9x. Management appears very confident in Evergy's ability to keep growing its EBITDA generation, and that's why the firm is willing to issue debt to repurchase shares. Note that management expects for the company to post a major growth spurt in 2020 as its growth trajectory is not linear (Evergy's CFO Tony Somma on the firm's latest quarterly conference call):

> *"It should be noted, the new EPS CAGR is not linear and we expect a jump going into 2020 above the 7% CAGR. We remain confident in the opportunity in front of us, and continue to believe in our compelling investment thesis that offers a competitive and risk adjusted shareholders return."*

That growth spurt will help keep Evergy's leverage ratios contained, as will its long-term growth story (from its latest quarterly conference call):

> *"The investment thesis from the get go with the merger was that we were going to be rate base growth story that both legacy companies had spent large amounts of capital growing rate base and the value of the merger was and combining these two companies and harvesting the efficiencies for both customers and investors."*

When it comes to Evergy's payout ratio, the utility posted $2.50 in GAAP earnings per share in 2018 and expects that to grow to $2.70–$2.90 this year. On a non-GAAP basis, Evergy is expecting its adjusted earnings per share to rise from $2.67 in 2018 to $2.80–$3.00 in 2019. Extrapolating Evergy's latest quarterly payout of $0.475 per share across an entire year, that indicates management is targeting a payout ratio around 65%–68% in 2019 (depending on whether one uses the firm's midpoint of its GAAP or adjusted earnings per share estimate for this year). There are of course plenty of variables here, including where Evergy lands on its guidance range (which has major implications in terms of its mid-cycle growth trajectory) and whether management pursues more aggressive or less aggressive dividend increases going forward.

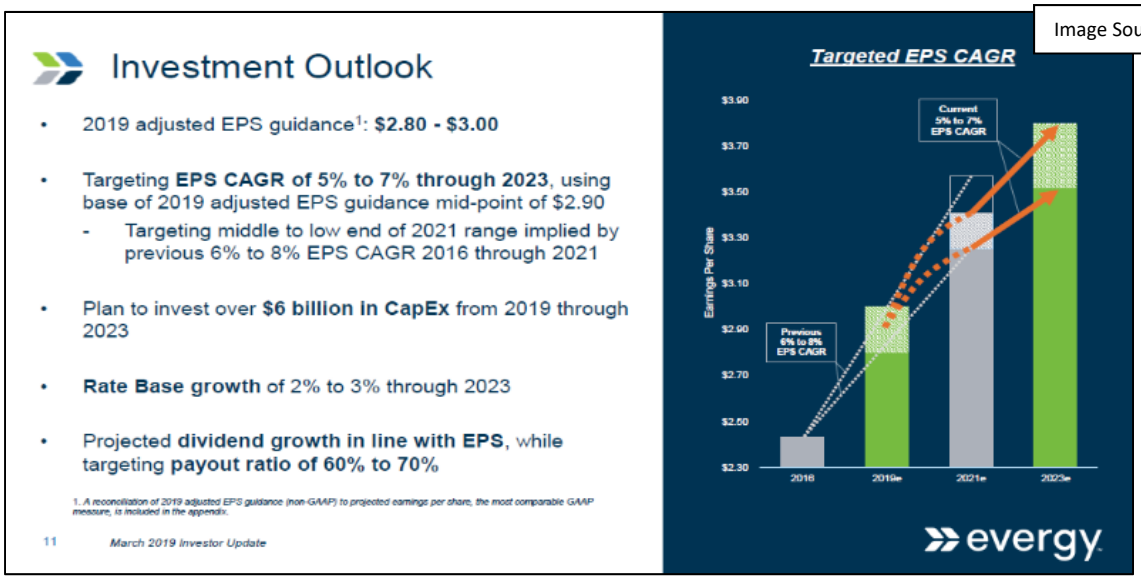


Image Source: Evergy

When investing in any security, including utilities, there are always risks investors should keep on their mind. The first big concern involves merger execution risk, as the company is banking heavily on the ability to realize a substantially amount of operation synergies, yet had only booked a portion of those cost savings as of the end of 2018. Secondly, there are regulatory risks surrounding utilities as any rate hike increase needs to first be approved by the relevant regulatory (be that FERC, the Kansas Corporation Commission, or the Missouri Public Service Commission), and Evergy had to enter into special agreements with Kansas and Missouri in order to get its merger approved.

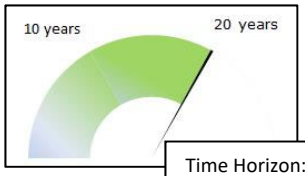
Thirdly, the company comes with a lot of geographic concentration risk as the firm's clients are primarily located in Kansas and Missouri, a region that would be negatively impacted by a prolonged trade war with China (which in turn could negatively impact regional electricity demand and thus Evergy's performance). Any natural disaster, such as severe flooding, could have a major impact on its financials. Finally, the fourth big risk comes down to its long-term liabilities, as management is actively issuing debt to buy back stock. That strategy is a bold bet on Evergy continuing to succeed with its post-merger growth story, something that cannot be fully assured.

We like Evergy's well-protected and growing 3.4% dividend yield as of this writing, which is backed by a clear growth trajectory, several investment grade credit ratings, operational synergies, and a management team that has their eyes set firmly towards the future. Having renewable energy represent a growing portion of its generation capacity removes a lot of long-term regulatory risk and ultimately those investments are required if Evergy is going to be around for decades if not centuries. Management's buyback program is bold but built on a logical foundation as Evergy retains easy access to capital markets and has a very good chance of maintaining its EBITDA growth trajectory over the coming years.

Year Ended December 31	2018 [a]	2017	2016	2015	2014
Evergy	(dollars in millions except per share amounts)				
Operating revenues	$ 4,276	$ 2,571	$ 2,562	$ 2,459	$ 2,602
Net income	$ 546	$ 337	$ 361	$ 302	$ 322
Net income attributable to Evergy, Inc.	$ 536	$ 324	$ 347	$ 292	$ 313
Basic earnings per common share	$ 2.50	$ 2.27	$ 2.43	$ 2.11	$ 2.40
Diluted earnings per common share	$ 2.50	$ 2.27	$ 2.43	$ 2.09	$ 2.35
Total assets at year end	$ 25,598	$ 11,624	$ 11,487	$ 10,706	$ 10,289
Total long-term obligations at year end [b]	$ 7,472	$ 3,846	$ 3,699	$ 3,379	$ 3,433
Cash dividends per common share	$ 1.735	$ 1.60	$ 1.52	$ 1.44	$ 1.40
Westar Energy					
Operating revenues	$ 2,615	$ 2,571	$ 2,562	$ 2,459	$ 2,602
Net income	$ 349	$ 337	$ 361	$ 302	$ 322
Net income attributable to Westar Energy, Inc.	$ 339	$ 324	$ 347	$ 292	$ 313
Total assets at year end	$ 11,817	$ 11,624	$ 11,487	$ 10,706	$ 10,289
Total long-term obligations at year end [b]	$ 3,817	$ 3,846	$ 3,699	$ 3,379	$ 3,433
KCP&L					
Operating revenues	$ 1,823	$ 1,891	$ 1,875	$ 1,714	$ 1,731
Net income	$ 163	$ 180	$ 225	$ 153	$ 162
Total assets at year end	$ 8,121	$ 8,124	$ 8,058	$ 7,815	$ 7,495
Total long-term obligations at year end [b]	$ 2,532	$ 2,582	$ 2,565	$ 2,563	$ 2,297

Image Source: Evergy

Disclosure: Independent contributor Callum Turcan wrote this article. Callum doesn't own shares in any of the companies mentioned in this article.



Time Horizon: Long-term

Everbridge Inc (EVBG)

"Our strong fourth quarter results were at the high end or above our guidance ranges for both revenue and profitability, providing a strong finish to a strong year, in which we generated 41% revenue growth…In the fourth quarter we saw continued momentum across our entire platform, and particular strength demonstrated by our Critical Event Management (CEM) products. We believe we are well-positioned to deliver further strong growth in 2019 with our CEM strategy extending our momentum in the marketplace and driving continued financial success as we further penetrate this multi-billion-dollar market."
-- Jaime Ellertson, Chief Executive Officer and Chairman of Everbridge

Thesis

Our April capital-appreciation idea in the Exclusive addresses a very important consideration that has unfortunately become too commonplace. This month's idea is Everbridge's (EVBG), and its Software-as-a-Service platform helps organizations respond to critical events and disasters to keep people safe and businesses running. The company's suite of products enables organizations to send and receive messages from hundreds of millions of people across multiple different communications devices, all at the same time.

Corporate Profile

Everbridge is a Software-as-a-Service (SaaS) company that helps organizations respond to crises to keep their people safe and their businesses running faster. The company has approximately 4,400 customers around the globe that rely on its platform to assess public safety threats, including active shooter situations, terrorist attacks or severe weather. Everbridge is based in Boston and Los Angeles. The company was founded after 9/11.

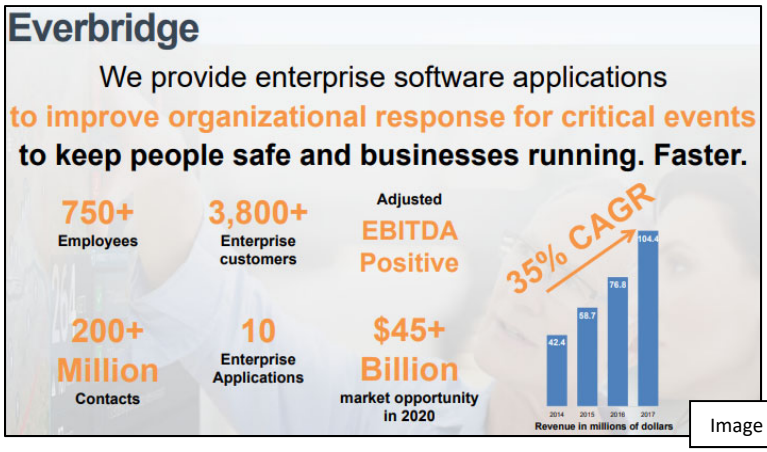


Image Source: Everbridge

Key Statistics	
Last Close	$72.75
52-week range	$34.84-$76.60
Market Cap	$2.4 B
Avg Daily Vol	436,847
Trailing P/E	NMF
Net Cash (LFY)	$11 M

Speculative Idea

Here's more background on the company's niche, from its fourth-quarter 2018 press release:

> *"During public safety threats such as active shooter situations, terrorist attacks or severe weather conditions, as well as critical business events including IT outages, cyber-attacks or other incidents such as product recalls or supply-chain interruptions, over 4,400 global customers rely on the company's Critical Event Management (CEM) Platform to quickly and reliably aggregate and assess threat data, locate people at risk and responders able to assist, automate the execution of pre-defined communications processes through the secure delivery to over 100 different communication devices, and track progress on executing response plans."*

It saddens me greatly that there may be demand for such services, but this is an unfortunate reality. Everbridge currently has a market capitalization of ~$2.5 billion, and its publicly-traded history isn't a long one, so this idea comes down to the market mispricing what could be tremendous long-term growth potential in demand for its SaaS platform. The company went public in September 2016, and thus far Everbridge continues to improve its technology to meet requirements of organizations to respond to ever-changing demand threats.

As Everbridge outlines in its 2018 10-K Annual Report:

> *"…the speed at which threats are assessed and information is transmitted and accessed is essential. For example, United States Department of Homeland Security research indicates that the average duration of an active shooter event at a school is approximately 12.5 minutes, while the average police response time to such events is 18 minutes. Accordingly, organizations must be able to aggregate multiple types of threat and incident data and determine whether their people, assets, or suppliers could be impacted, rapidly deliver messages that are tailored to multiple, specific audiences, in precise locations and be assured of delivery."*

Everbridge discusses a number of competitive advantages in its regulatory filings. For starters, its platform has multiple checks and balances in order to ensure the delivery and verification of key communications anywhere. The company's SaaS platform can be best described as "out-of-the-box" and can generally be put to work without the customer having to develop or maintain the platform. Everbridge's system aggregates data and analysis from a number of feeds, including public safety and threat data feeds, social media, and IT monitoring systems. The company's platform is robust, in our view, and its list of representative customers is impressive.

Enterprise	Healthcare	State and Local Government
Alexion Pharmaceuticals	Alexian Brothers Medical Center	Boston Police Department
Choice Hotels	Boston Children's Hospital	Chicago Department of Aviation
Digital Realty	Catholic Health Initiatives	City of Torrance
DTE Energy	Children's Hospital of Philadelphia	Florida Division of Emergency Management
		Harris County, Texas
East West Bank	Covenant Health System	Los Angeles Police Department
EnerNOC	Doctors Health at Renaissance Health System	Miami International Airport
Ericsson	Florida Health	Muskingum Watershed Conservancy District
Express Scripts	Hawaii Pacific Health	National Capital Region
Facebook	Molina Healthcare	New York City, Emergency Management Department
Hulu	Penn State Health Milton S. Hershey Medical Center	Northeast Region Community Awareness
Olympus Corporation of the Americas	Penrose St. Francis Health Services	Emergency Response
Pearson	Spectrum Health	State of Connecticut, Department of
Sierra Nevada	University Medical Center of El Paso	Emergency Services and Public Protection
Uber	Vanderbilt University Medical Center	University of Louisiana System
Xerox		U.S. Department of Transportation
		Vermont Department of Public Safety

Image Source: Everbridge

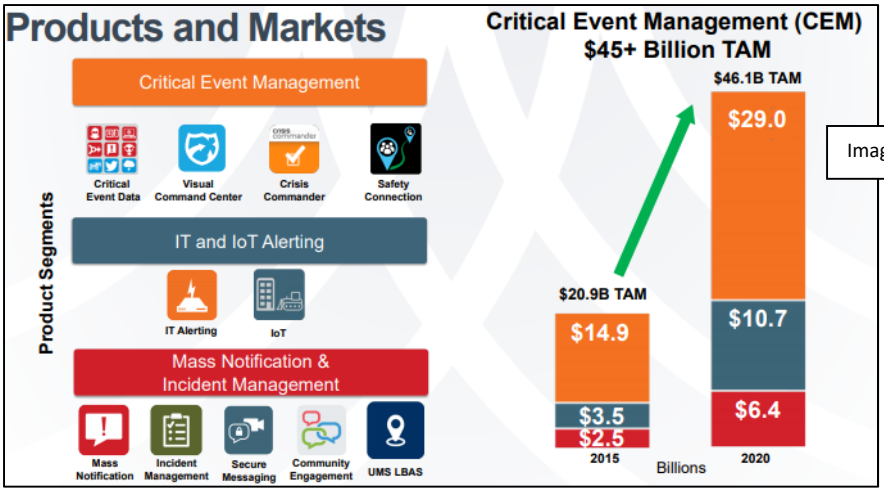
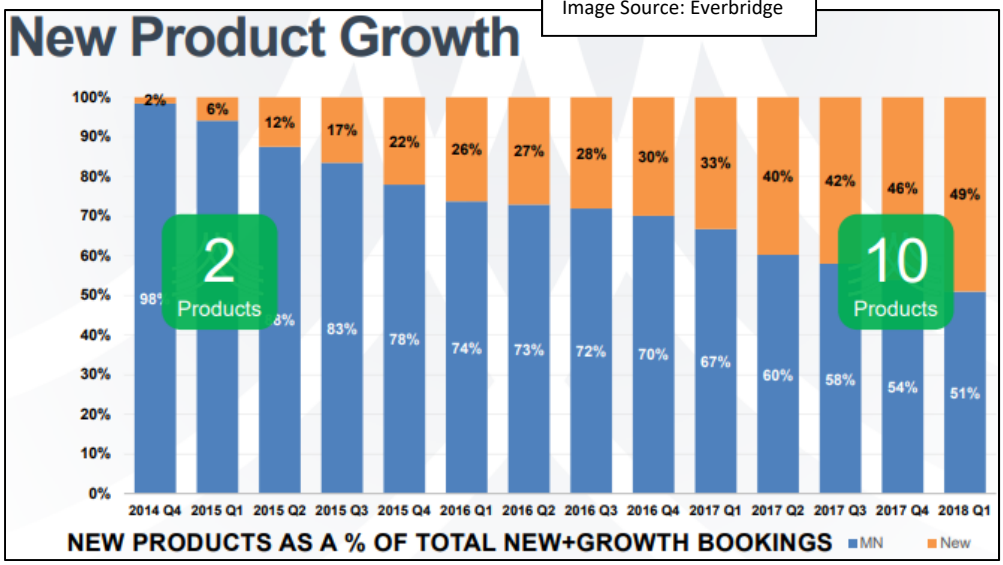


Image Source: Everbridge 2018

The market for CEM could be as much as $40+ billion worldwide by 2020, and the market for mass notification software and services is projected to grow to $6.4 billion in 2020 (see prior image). Everbridge's revenue was just $147 million in 2018, and the company has a multi-point plan for organic growth: 1) gain new customers by marketing its portfolio of applications, 2) further penetrate its existing customers by adding new features (see image that follows), 3) develop new applications in order to target new market segments, and 4) expand internationally (Europe, the Middle East and Asia offer opportunities). Making sure that its technology remains top of the line and augmenting its portfolio of applications with complementary businesses may only help add to its competitive advantages and growth profile.

Image Source: Everbridge



That said, while the opportunity for expansion is material, there are also meaningful risks. As Everbridge notes, "the market for CEM solutions is highly fragmented, intensely competitive and constantly evolving." The company leaves no doubt in its opinion that competition will remain intense on a go-forward basis, too. The landscape is highly fragmented, and some of the key rivals include BlackBerry, Nuance Communications, OnSolve, Rave Wireless, and SunGard Data Systems. PagerDuty and xMatters compete in IT alerting applications, while DocHalo, Spok and Perfect Serve vie for market share in secure messaging. We think Everbridge has a solid position with respect to its portfolio of applications as well as its intellectual property (it has 80+ worldwide patents), but competition changes fast.

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(in thousands, except shares and per share data)				
Revenue	$ 147,094	$ 104,352	$ 76,846	$ 58,720	$ 42,421
Cost of revenue(1)	46,810	31,503	23,767	19,789	12,089
Gross profit	100,284	72,849	53,079	38,931	30,332
Operating expenses:					
Sales and marketing(1)	$ 69,608	$ 46,998	$ 34,847	$ 25,925	$ 15,818
Research and development(1)	41,305	22,241	14,765	11,521	7,365
General and administrative(1)	31,462	22,895	14,293	12,272	7,435
Total operating expenses	142,375	92,134	63,905	49,718	30,618
Operating loss	(42,091)	(19,285)	(10,826)	(10,787)	(286)
Other expenses, net	(4,628)	(302)	(484)	(599)	(426)
Loss before income taxes	(46,719)	(19,587)	(11,310)	(11,386)	(712)
(Provision for) benefit from income taxes	(796)	(47)	24	562	89
Net loss	$ (47,515)	$ (19,634)	$ (11,286)	$ (10,824)	$ (623)
Net loss attributable to common shareholders	$ (47,515)	$ (19,634)	$ (11,286)	$ (10,824)	$ (623)
Net loss per share attributable to common shareholders - basic	$ (1.63)	$ (0.70)	$ (0.68)	$ (0.88)	$ (0.05)
Net loss per share attributable to common shareholders - diluted	$ (1.63)	$ (0.70)	$ (0.68)	$ (0.88)	$ (0.05)
Weighted average shares outstanding - basic	29,107,267	27,862,375	16,659,561	12,257,413	11,788,883
Weighted average shares outstanding - diluted	29,107,267	27,862,375	16,659,561	12,257,413	11,788,883

Image Source: Everbridge

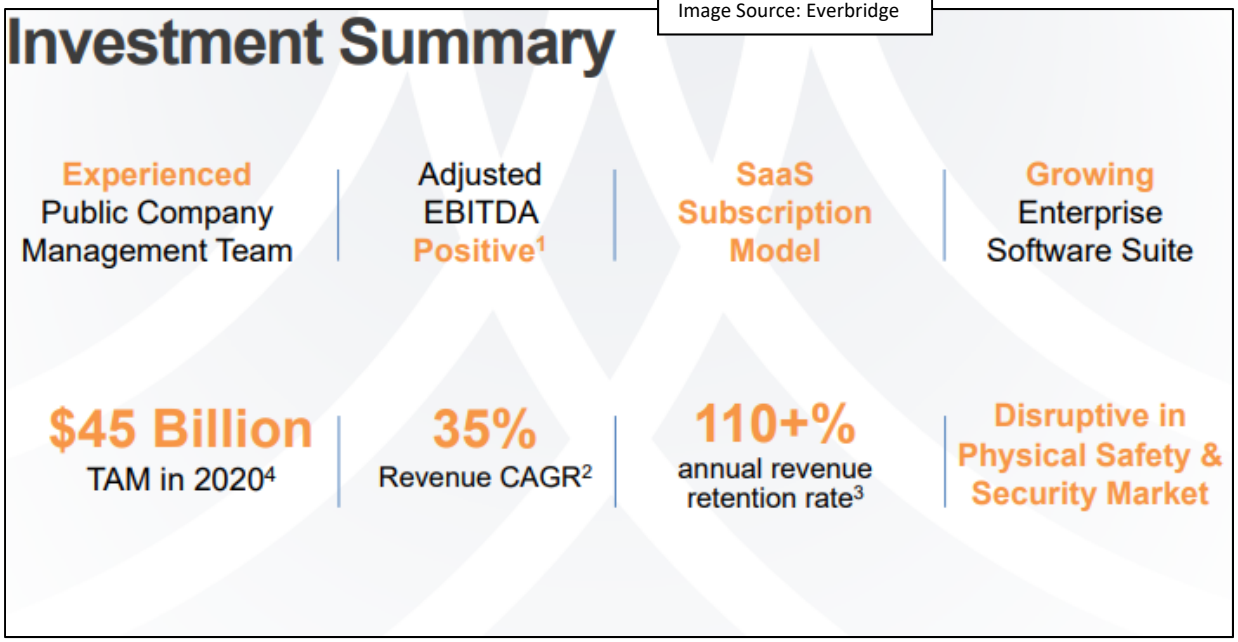
Image Source: Everbridge

	As of December 31,				
	2018	2017	2016	2015	2014
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 59,978	$ 102,754	$ 60,765	$ 8,578	$ 4,412
Working capital, excluding deferred revenue	135,206	166,589	70,488	15,160	1,760
Total assets	262,180	236,413	108,322	53,509	40,066
Total deferred revenue	95,636	73,072	52,634	40,467	28,844
Total debt	94,524	89,481	—	16,970	6,863
Total liabilities	220,022	180,422	65,970	69,560	45,393
Total stockholders' equity (deficit)	42,158	55,991	42,352	(16,051)	(5,327)

Let's get to brass tacks. Everbridge has posted a net loss in each year since inception, and it has progressively gotten worse. Its business depends heavily on leveraging its resources for growth and then scaling operating costs to drive a profit, all the while managing a rather meaningful debt load. Though Everbridge has a predictable SaaS recurring revenue model, it has yet to prove that it is able to drive sustained profitability, even if adjusted EBITDA is targeted in the range of $4-$5 million for fiscal 2019, the best in years. An investment in Everbridge is not for the faint of heart, and while we believe we've identified a niche player in an area of growing need, competition is fierce and may only grow more intense over time. Everbridge's own systems can potentially be exposed to security breaches, too, which may harm its reputation, an outsize risk for a firm that depends on data security and reliability for success.

The company's 52-week trading range is between ~$35 and $76 per share, and it is bumping against all-time highs at the time of this writing. We like the share-price momentum and market confidence in Everbridge, but for a company that continues to lose money, it's difficult to get a handle on a fair value range any tighter than that. We could see upside to what might amount to 10% of the total addressable market for CEM, or north of $4 billion in market cap, but this may be more of a speculative valuation at this time. We like Everbridge's positioning and opportunity, but a lot of caution is in order. Not only does the company face execution risk, but it operates in an area that leaves little margin for error. Investors should tread lightly with this April Exclusive capital-appreciation idea.

Image Source: Everbridge



Except as otherwise noted below, the address for persons listed in the table is c/o Everbridge, Inc., 25 Corporate Drive, 4th Floor, Burlington, Massachusetts 01803.

Image Source: Everbridge

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Shares Beneficially Owned
5% or greater stockholders:		
Alger Associates, Inc.(1)	1,665,161	5.9%
Named executive officers and directors:		
Jaime Ellertson(2)	1,322,613	4.6%
Kenneth S. Goldman	1,742	*
Robert Hughes	—	—
Richard D'Amore(3)	14,493	*
Bruns Grayson(4)	1,362,272	4.8%
David Henshall(3)	14,493	*
Kent Mathy(3)	53,190	*
All current executive officers and directors as a group (10 persons)(5)	3,238,263	11.2%

* Represents beneficial ownership of less than 1%.

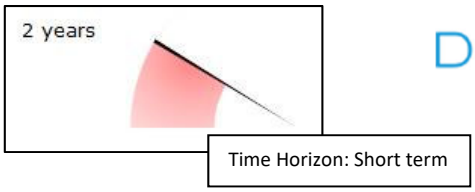
(1) The address of Alger Associates, Inc. is 360 Park Avenue South, New York, NY 1001. The information shown is based on a Schedule 13D filed on February 14, 2018 by Alger Associates, Inc.

(2) Includes 325,785 shares of common stock issuable upon the exercise of options that are exercisable on or before March 2, 2018 and 86,956 shares of common stock held by one of Mr. Ellertson's children.

(3) Consists of shares of common stock issuable upon the exercise of options that are exercisable on or before March 2, 2018.

(4) Includes 1,000,000 shares of common stock held by ABS Ventures IX, L.P., 219,166 shares of common stock held by Calvert Capital V LLC, the general partner of ABS Ventures IX, L.P., and 4,567 shares of

Short Consideration



Diplomat Pharmacy Inc (DPLO)

Thesis

America's aging demographics indicates healthcare expenditures will continue rising over the coming years and decades, which speaks well for companies that operate in the space. However, the domestic healthcare sector is witnessing some structural shifts that will negatively impact Diplomat Pharmacy's financial performance regardless of macro tailwinds. Diplomat is experiencing increased competition at its Specialty business, which is putting downward pressure on its prescription volumes and long-term growth trajectory. At its PBM business, questions are arising about whether Diplomat can retain its relatively high rebate retainage percentage after incurring major impairment charges in 2018 relating to its two PBMs acquisitions in 2017. The company does not pay a dividend at this time.

Problems at Diplomat Pharmacy really began picking up pace last year after its move into the PBM services space turned out to have been a bad idea. Those two deals were covered by $546 million in cash and $96 million in common stock issuance according to the November press releases.

Corporate Profile

Diplomat Pharmacy Inc provides specialty pharmacy and infusion services in America, catering to patients with complex medical needs who rely on drugs with limited availability and require special handling. The company can now offer PBM services (pharmacy benefits management) to its patients as Diplomat purchased two PBMs during the fourth quarter of 2017. At the end of 2018, Diplomat's operations were supported by approximately 180 licensed pharmacists.

Key Statistics	
Last Close	$5.69
52-week range	$5.16-$28.74
Market Cap	$423 M
Avg Daily Volume (30 weeks)	1,133,583
Shares Outstanding	74.45 M
Float	50.07 M
Short Ratio	2.78
Short % of Float	13.3%
Shares short (prior month)	8.51 M

By the end of 2018, Diplomat had recorded a $262 million impairment charge relating to those acquisitions, along with an unrelated $46 million impairment charge relating to its Specialty business. Put another way, after paying roughly $640 million, Diplomat wrote-off almost half of its bet on the PBM space in just one year. The company was asked about whether or not it would be able to retain its relatively high rebate retention at its PBM services business during its latest quarterly conference call and management didn't have a straightforward answer to give. However, it appears the company is hoping demand for alternative PBM services models picks up, which so far has not been the case (from Diplomat's latest conference call):

> *"Within the small to midsized market that we play in,* ***we have not seen a demand from the market, the broker consultant community or our clients around alternative models****. Now that being said, we currently are out in the market with a broad range of alternative products…*
>
> *We've got* ***clients now that are basically moving toward rebates at the point of sale, so basically at the consumer level. So our model is really just to offer alternatives*** *and let the client make the determination as to what model that they -- works best for them."*

It appears Diplomat is leaning on a strategy of hope as its cut of the rebates (regarding drug prices), that are in theory supposed to go to the patients, are now increasingly going to the patients. That is a trend which is growing, not shrinking, indicating tougher times ahead.

What makes matters worse is that Diplomat took on a lot of debt to fund those acquisitions. At the end of 2016, Diplomat was sitting on a manageable net debt load of $139 million. By the end of 2017, that had jumped up to $637 million. The company did manage to lower its net debt burden down to $617 million by the end of 2018, but going forward, note that hefty interest expenses are weighing negatively on its ability to churn out cash flow. On a side note, the company saw its diluted outstanding share count rise by 9% from 2016 to 2018, and that dilution is expected to continue going forward according to guidance.

Diplomat's annual interest expenses jumped from $7 million in 2016 to $42 million in 2018. As the company recorded over $300 million in impairment charges last year, let's take a look at its adjusted operating income instead (defined as gross profit minus the firm's only other operating expense, SG&A). Last year, the company posted just $40 million in adjusted operating income, coming in below its annual interest expense.

Management needs to unlock some serious synergies and revive the specialty pharmacy's top-line growth and preserve its margins as a large tranche of its debt load comes due in 2022. The company's cash position stood at just $9 million at the end of 2018. While its liquidity needs are supplemented by its $250 million revolving credit line, the company has already drawn $176 million of that revolver's capacity. Furthermore, the credit line matures at the same time as its Term Loan A in December 2022. Term Loan B matures two years later, giving Diplomat some breathing room but not much as that burden is significantly larger than Term Loan A as you can see below.

Image Source: Diplomat Pharmacy

Total outstanding debt consisted of the following:

	December 31, 2018	December 31, 2017
Short-term debt, borrowings on line of credit	$ 176,300	$ 188,250
Long-term debt:		
Term loan A	$ 142,500	$ 150,000
Term loan B	322,000	400,000
Total	464,500	550,000
Unamortized debt issuance costs	(14,631)	(17,402)
Total long-term debt	449,869	532,598
Less: current portion	11,500	11,500
Long-term debt, less current portion	$ 438,369	$ 521,098

At December 31, 2018, the Company's scheduled principal payments on its Term Loan A and Term Loan B for the next five years is as follows:

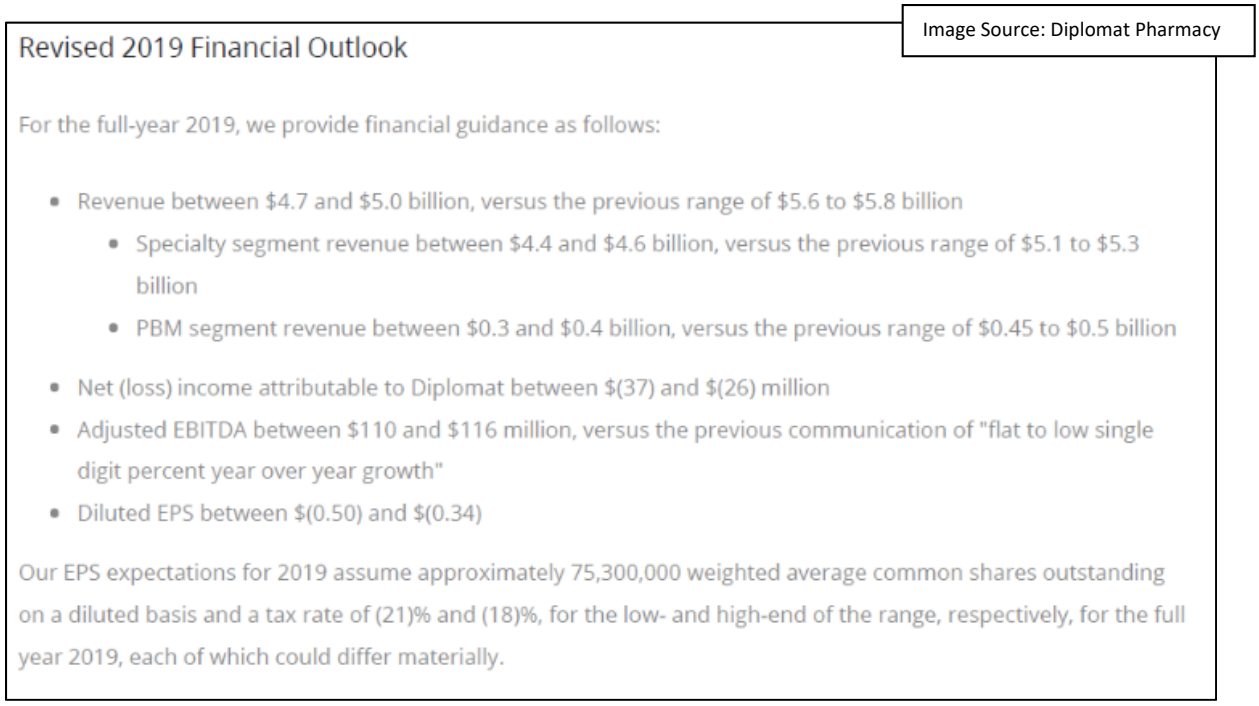
2019	$ 11,500
2020	11,500
2021	11,500
2022	124,000
2023	4,000

Image Source: Diplomat Pharmacy

In order to retain access to capital markets and generate shareholder value over the long-term, Diplomat needs to showcase that its new business model works. So far, not only has that strategy gotten off to a rough start, management expects the pain to continue through at least 2019 at time when Diplomat needs to be showing serious improvement. **Moody's downgraded Diplomat's credit rating at the end of February to B2 from B1 with a negative outlook as its leverage ratio looks like it will remain elevated for some time.**

Diplomat issued weak guidance for 2019 as the company is losing its PBM customers and failing to win over a substantial number of new clients, on top of its specialty prescription business losing out on prescription fills as competition in the space heats up. Gross and operating margins are coming under fire as Diplomat is *"absorbing increased competitive pressures in the specialty market, driving a reduced outlook per script volumes and associated revenues and profits in 2019."*

Image Source: Diplomat Pharmacy



Revised 2019 Financial Outlook

For the full-year 2019, we provide financial guidance as follows:

- Revenue between $4.7 and $5.0 billion, versus the previous range of $5.6 to $5.8 billion
  - Specialty segment revenue between $4.4 and $4.6 billion, versus the previous range of $5.1 to $5.3 billion
  - PBM segment revenue between $0.3 and $0.4 billion, versus the previous range of $0.45 to $0.5 billion
- Net (loss) income attributable to Diplomat between $(37) and $(26) million
- Adjusted EBITDA between $110 and $116 million, versus the previous communication of "flat to low single digit percent year over year growth"
- Diluted EPS between $(0.50) and $(0.34)

Our EPS expectations for 2019 assume approximately 75,300,000 weighted average common shares outstanding on a diluted basis and a tax rate of (21)% and (18)%, for the low- and high-end of the range, respectively, for the full year 2019, each of which could differ materially.

Diplomat generated $5.5 billion in net sales last year and previously was forecasting for moderate top-line growth in 2019. That is no longer that case as management expects Diplomat's revenue will contract by 9% on an annual basis at the midpoint of guidance, which will likely put tremendous pressure on its operating margins. From 2017 to 2018, Diplomat's SG&A expenses grew by 31% as a result of the move into the PBM space, and those expenses are unlikely to retreat this year. Management is cognizant of the need to adjust Diplomat's business model and said as much during its latest earnings conference call:

> *"Today, our existing cost structure is not supported by the current business environment, and we're making needed adjustments now. We recently conducted a broad review of the company's operations and cost structure and have identified and are executing on numerous operational efficiency initiatives that are expected to contribute to 2019 adjusted EBITDA. We are executing on company-wide restructuring initiatives, including facilities consolidations, reduce staffing levels, while delivering high-quality patient care and prioritizing investments. While focused on operational improvement and reducing costs, we remain committed to investing in the business to position Diplomat to return to growth and achieve improved profitability."*

Reducing the company's headcount will likely represent management's first step in bringing down costs, but note that this process generally incurs restructuring charges (particularly severance payouts). Consolidating its backroom operations and potentially some of its facilities could yield additional synergies on the cost side, but the upside hasn't yet been quantified by management. The launch of its ScriptMed specialty operating platform is expected to reduce Diplomat's cost to fill prescriptions as the company rolls out the program.

Management noted that the company had *"immediate line of sight to over $10 million in savings, and we believe that there's upside beyond that"* but note that this was already *"baked into our 2019 guidance"* which was abysmal. Generally speaking, when companies issue weak guidance, cost cutting goals and targets start being thrown around in order to provide support to the firm's mid-cycle valuation and give the appearance things are changing.

One area Diplomat performs decent in is free cash flow, as the firm generated $35 million in net operating cash flow in 2018 while spending just $10 million on capital expenditures. In 2017, Diplomat generated $135 million in net operating cash flow while spending just $7 million on capital expenditures. However, this uneven performance makes the firm's future free cash flow trajectory hard to gauge. Until Diplomat revives top-line growth and figures out what kind of business model works best in the current healthcare environment, its cash flow generation will likely come under fire.

Diplomat is hoping that the launch of new specialty pharmaceutical products in the future will revive growth at its core business, with management noting around two-thirds of expected drug launches over the next five years are expected to be within the specialty category. The company is also expected to win some reprieve from industry consolidation, making the specialty pharmacy industry less fragmented and potentially providing upward pressure on margins. Management also referenced investing in data intelligence and predictive analytics capabilities to make the firm more appealing as a partner to hospitals, health care plan providers, and other healthcare players. That being said, it appears Diplomat's medium-term goals revolve around cutting costs much more so than driving revenue growth, as top-line growth may be a way off due to structural factors Diplomat can't avoid.

Diplomat's stock price was pummeled after its latest earnings report, but the firm still retains a market capitalization north of $400 million as of this writing. Both its specialty pharmacy and PBM service businesses are coming under intense competitive pressure with no end in sight, and Diplomat doesn't have the financial capacity to make the large investments needed to offset these customer losses. Dwindling revenue streams combined with a business model that hasn't proven successful will culminate in weaker financial performance going forward, ultimately creating a massive problem for the firm as its large debt burden gets ever closer to maturing. Operating in the healthcare sector, especially as a smaller company, is tough during the best of times. Diplomat waded into waters it should have left undisturbed so it could have focused more so on its core business. Bigger picture changes in the structure of America's healthcare system could have a very negative impact on Diplomat's profitability. We are expecting things to get worse for Diplomat Pharmacy.

Image Source: Diplomat Pharmacy

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands, except per share amounts)				
Consolidated Statements of Operations Data					
Net sales	$ 5,492,524	$ 4,485,230	$ 4,410,388	$ 3,366,631	$ 2,214,956
Cost of sales (1) (2)	(5,116,515)	(4,211,085)	(4,144,802)	(3,147,693)	(2,098,992)
Gross profit (1) (2)	376,009	274,145	265,586	218,938	115,964
Selling, general and administrative expenses (1) (2)	(335,650)	(255,580)	(213,705)	(173,001)	(103,381)
Goodwill impairments (3)	(224,966)	—	—	—	—
Impairments of definite-lived intangible assets (3)	(82,678)	—	(4,804)	—	—
(Loss) income from operations	(267,285)	18,565	47,077	45,937	12,583
Other (expense) income:					
Interest expense	(41,650)	(10,716)	(6,573)	(5,239)	(2,528)
Equity loss and impairment of non-consolidated entities	(329)	—	(4,659)	—	(6,208)
Change in fair value of redeemable common shares	—	—	—	—	9,073
Termination of existing stock redemption agreement	—	—	—	—	(4,842)
Other	1,956	213	370	308	1,128
Total other expense	(40,023)	(10,503)	(10,862)	(4,931)	(3,377)
(Loss) income before income taxes	(307,308)	8,062	36,215	41,006	9,206
Income tax benefit (expense)	5,039	7,126	(11,195)	(16,234)	(4,655)
Net (loss) income	(302,269)	15,188	25,020	24,772	4,551
Less net loss attributable to noncontrolling interest	—	(322)	(3,253)	(1,004)	(225)
Net (loss) income attributable to Diplomat Pharmacy, Inc.	(302,269)	15,510	28,273	25,776	4,776
Net income allocable to preferred shareholders	—	—	—	—	458
Net (loss) income allocable to common shareholders	$ (302,269)	$ 15,510	$ 28,273	$ 25,776	$ 4,318
(Loss) income per common share:					
Basic	$ (4.07)	$ 0.23	$ 0.43	$ 0.42	$ 0.12
Diluted	$ (4.07)	$ 0.23	$ 0.42	$ 0.41	$ 0.11
Weighted average common shares outstanding:					
Basic	74,244,520	68,130,322	65,970,396	60,730,133	36,012,592
Diluted	74,244,520	68,780,053	68,047,723	63,096,951	38,553,995

	As of December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Consolidated Balance Sheet Data					
Total assets	$ 1,476,359	$ 1,940,423	$ 1,099,254	$ 1,001,579	$ 390,086
Total debt	626,169	720,848	146,939	117,000	—
Total shareholders' equity	465,084	749,501	613,724	515,546	168,727

Disclosure: Independent contributor Callum Turcan wrote this article. Callum doesn't own shares in any of the companies mentioned in 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.

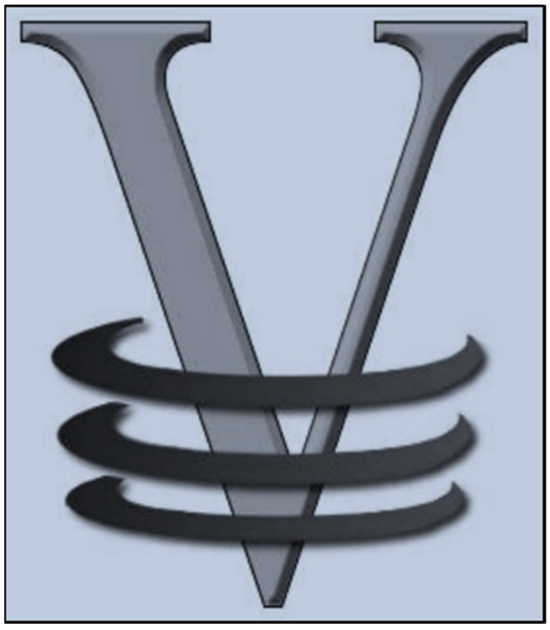
Within the twelve editions of the Nelson Exclusive each year, we'll be highlighting in total 36 ideas for consideration with varying investment parameters. That's a lot. Depending on the time horizon set forth with each idea, fantastic performance might mean a success rate of 60%, great performance might 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.
brian@valuentum.com



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 4, Issue 4

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(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.